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HOUSING FINANCE REFORM—MAINTAINING ACCESS FOR SMALL LENDERS

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIFTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING THE ROLES THAT SMALL LENDERS PLAY IN THE MORTGAGE MARKET

JULY 20, 2017

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HOUSING FINANCE REFORM—MAINTAINING ACCESS FOR SMALL LENDERS

THURSDAY, JULY 20, 2017

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:04 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Mike Crapo, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN MIKE CRAPO

Chairman CRAPO. This hearing will come to order.

Today the Committee will continue its series of hearings on housing finance reform. In May, Treasury Secretary Mnuchin and FHFA Director Watt both appeared before the Committee and gave their perspectives on the state of housing finance and the housing finance reform prospects.

In June, we held a hearing on the principles of housing finance systems featuring three witnesses, each with a deep background in housing finance. Today we will hear from a range of small lenders, representing community banks, credit unions, and non-depositories.

Small lenders play a critical role in the mortgage market. This is especially true in rural States like Idaho, as well as other communities across the country. Small lenders are often fixtures in their communities who extend credit based on local knowledge and expertise.

As we contemplate how to reform the housing system, we must understand how small lenders access the secondary market and ensure that such access is preserved in the new system.

Today small lenders often sell mortgage loans to Fannie Mae and Freddie Mac through the cash window at each enterprise, which allows lenders to exchange individual loans for cash. Among the benefits of the cash window is that it allows small lenders to access the secondary market without selling loans to competitors.

I look forward to hearing from our witnesses today regarding what a reformed system must include to ensure small lenders can access the secondary market.

In past hearings on housing, I have discussed housing finance reform principles that I believe share bipartisan support. We need to preserve the to-be-announced market and an affordable, accessible 30-year fixed-rate mortgage.

We must have multiple levels of taxpayer protection standing in front of any Government guarantee, including downpayments, loan-level insurance, and, very importantly, substantial, robust, loss-absorbing private capital.

The transition to a new system must be orderly and deliberate, and it should utilize existing market infrastructure where possible. These are foundational principles that are consistent with many of the reform plans that have been proposed in recent years.

Fannie Mae and Freddie Mac have been in conservatorship for close to 9 years. While some have grown accustomed to the current system, the status quo is not sustainable. A mortgage market dominated by two huge Government-sponsored companies in conservatorship is not a long-term solution and is not in the best interest of consumers, taxpayers, lenders, investors, or the broader economy.

The GSEs are currently earning profits, but taxpayers could again be on the hook for billions of dollars when the housing market experiences its next downturn. Reform is urgently needed.

I look forward to working with other Members of this Committee and the witnesses today, as well as the groups they represent, as we develop a long-term solution for our housing finance system.

Senator Brown.

STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Chairman Crapo. Thank you for holding this hearing. I would like to first welcome all of our witnesses, including a lender from Ohio.

Tim Mislansky is the senior vice president/chief lending officer at Wright–Patt Credit Union. He lives in West Chester, Ohio. The credit union is located outside of Dayton in Beavercreek. It serves the Dayton area and communities between Cincinnati and Columbus like Xenia.

His credit union is the largest lender on this panel, with $3.5 billion in assets. There is some irony in that always at our Committee hearings, and I appreciate Ms. Hughes being here as a constituent of Chairman Crapo. I also find it interesting that the ABA is almost never represented by the people that stop by my office as the CEO of one of the largest banks in America did yesterday. It is always represented by a community bank. I appreciate that. I appreciate your being here, but I also always find that a bit interesting.

Tim knows how small lenders serve smaller cities and suburban markets. His expertise is a valuable addition to our housing finance reform process. I thank him for that.

As we have heard repeatedly in this Committee, small lenders are often the only lenders willing to go the extra mile to underwrite mortgages in areas that are too often left behind by Washington and by Wall Street—in cities' urban core and in rural communities. Community lenders know their customers and the needs and challenges of the cities and the towns they serve.

During the Committee's last effort, 3 years ago, I guess, on housing finance reform, S. 1217 included a small lender mutual, but the system created in the bill simply did not include enough protections to prevent large lenders from controlling the secondary market. Without firewalls between the primary and secondary markets, we lose a layer of accountability for underwriting; we create loopholes that permit concentration of risk.

We saw during the housing crisis how consolidation of primary market and secondary market operations within a single entity can hurt borrowers and hurt entire communities.

The Financial Crisis Inquiry Commission found that in 2008, private label loans had a delinquency rate of over 28 percent compared to a delinquency rate of just 6 percent for GSE loans. That discrepancy is pretty alarming and illuminating. States like Ohio and Nevada are still feeling the impact of those predatory private loans.

In the same way that the GSEs are prohibited from originating mortgages, originators and their parent companies should be prohibited from any ownership of guarantors.

Proposals for reform range from a complete overhaul of the mortgage market to narrow, surgical changes. Looking at what current and future homeowners and lenders stand to lose in reform is as important as the desire to change the system.

Looking out for Americans who are trying to buy homes and stay in homes and build better lives for their families has to be by far the number one priority of this Committee and of this legislation.

I look forward to hearing from our witnesses about how the housing finance system could be improved and should be improved to better serve small lenders and their customers, as well as what should be preserved and protected.

While we are discussing the importance of community lenders, we should also include the important work of housing counselors, CDFIs, and community organizations.

Their work helped families achieve stable home ownership before the crisis and helped families keep their homes during the crisis. The importance of pre- and post-purchase housing counseling cannot be ignored during this legislative process.

As we continue to debate the role of the GSEs, private capital, and large financial institutions in providing access to affordable mortgages, we cannot and should not create a system that allows the GSEs or new players to use a business model that serves only the largest lenders, the highest income borrowers, or the well-off pockets of our country. I think you all recognize that. We need a model that allows all Americans, in every corner of the country, to become homeowners and to remain homeowners.

If the Government is going to have a role backing the housing market—and I believe we should—then that market must work for everyone, everywhere, not just those with the most lobbyists in this town and not just those with the deepest pockets.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you, Senator Brown.

Now we will turn to the oral testimony. First, we will receive testimony from Ms. Brenda Hughes, senior vice president and director of mortgage and retail lending at First Federal Savings Bank of Twin Falls, Idaho, on behalf of the American Bankers Association. And thanks, Brenda, for bringing some of Idaho's common sense here to Washington.

Ms. HUGHES. Good morning.

Chairman CRAPO. Next we will hear from Mr. Tim Mislansky, senior vice president and chief lending officer of Wright–Patt Credit Union, and president of myCUmortage, on behalf of the Credit Union National Association.

Then we will hear from Mr. Jack E. Hopkins, president and CEO of CorTrust Bank, on behalf of the Independent Community Bankers of America.

Following Mr. Hopkins, we will hear from Mr. Charles M. Purvis, president and CEO of Coastal Federal Credit Union, on behalf of the National Association of federally Insured Credit Unions.

Then we will hear from Mr. Wes Hunt, president of Homestar Financial Corporation, on behalf of the Community Mortgage Lenders of America.

And, finally, we will hear from Mr. Bill Giambrone, president and CEO of Platinum Home Mortgage, on behalf of the Community Home Lenders Association.

Each witness is recognized for 5 minutes of oral remarks, and, Ms. Hughes, you may proceed.

STATEMENT OF BRENDA HUGHES, SENIOR VICE PRESIDENT AND DIRECTOR OF MORTGAGE AND RETAIL LENDING, FIRST FEDERAL SAVINGS BANK OF TWIN FALLS, IDAHO, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Ms. HUGHES. Good morning. Thank you.

Chairman Crapo, Ranking Member Brown, my name is Brenda Hughes. I serve as senior vice president and director of mortgage and retail lending for First Federal Savings Bank of Twin Falls, Idaho. We are a $607 million asset savings association founded in 1915. I appreciate the opportunity to be here to present ABA's views on GSE reform and community bank access.

This issue is a critical one for our country. Americans have relied on access to long-term fixed-rate mortgages for 70 years. Fannie Mae and Freddie Mac have facilitated access to this product by providing access to the capital markets for private market lenders. The GSEs have been in conservatorship for nearly 9 years. We should not delay reform any longer.

Absent aggregation and securitization, access to long-term, lower-rate funding would be far more difficult to come by for most primary lenders. The Government guarantee provided to mortgage-backed securities guaranteed by the GSEs makes them attractive to capital markets ensuring liquidity. As we consider reform, these elements must be preserved and remain available to support all primary market participants regardless of size or location.

First Federal relies on this access and actively delivers loans directly to Freddie Mac, retaining servicing on these loans. We currently service approximately 5,000 loans. Like so many banks, both large and small, access to the secondary market through the federally guaranteed secondary market enterprises is essential to our ability to meet the mortgage needs of our customers.

ABA has worked with bankers from all institutions of all sizes and from all parts of the country to develop shared principles which should guide reform of the GSEs. From my testimony today, I would like to highlight a few key principles. More detail on these principles can be found in my written testimony.

We believe that the following principles should form the basis for legislative reform efforts:

First, the GSEs must be strictly confined to a secondary market role, providing stability and liquidity to the primary mortgage market for low- and moderate-income borrowers. They must be strongly regulated, thoroughly examined, and subject to immediate corrective action for regulatory violations.

In return for their GSE status and the associated benefits, entities must agree to support all segments of the primary market and all economic environments and provide equitable access to all primary market lenders. This includes preservation of the to-be-announced market and both servicing retained and sold options.

Mortgage-backed securities issued by the GSEs should carry an explicit guarantee from the Federal Government. These guarantees should be fully paid for through the guarantee fees equitably assessed. The GSEs must be capitalized appropriately. Strong capital must be tied to sound underwriting practices to ensure that it is representative of the risk of these institutions.

Credit risk transfers required by FHFA should be continued and expanded. The vital role played by the Federal Home Loan Banks, not to be confused with the roles of Fannie Mae and Freddie Mac, is working today and must not be impaired.

Congress has an essential role in providing the certainty necessary to ensure long-term stability of the housing finance system. Without legislative reform, past abuses may be repeated.

Some will argue that this can be accomplished by a regulation, and FHFA has done an admirable job in recent years ensuring the equitable treatment and addressing other past abuses. However, regulators and regulatory approaches can change over time. While a strong regulator must be part of the reform, so, too, must be clearer statutory guidance.

Reform need not be radical or extreme, but targeted and surgical. Legislation need not create an entirely new secondary market structure. In fact, guided by these key principles, we believe that relatively tailored legislation that takes a surgical approach to making necessary alterations to the current system is both desirable and achievable.

These legislative reforms are critical. Just as the Federal debt market provides the bellwether that makes all private debt markets more efficient and liquid, an explicit, fully priced, fully paid for Federal guarantee for a targeted portion of the mortgage market will be a catalyst for broader market growth and development. Congress should not defer action any longer. Nine years of conservatorship is more than enough.

Thank you for the opportunity to share our views with the Committee. I am happy to answer any questions you might have.

Chairman CRAPO. Thank you, Ms. Hughes.

Mr. Mislansky.

STATEMENT OF TIM MISLANSKY, SENIOR VICE PRESIDENT AND CHIEF LENDING OFFICER, WRIGHT–PATT CREDIT UNION, AND PRESIDENT, MYCUMORTGAGE, LLC, ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION

Mr. MISLANSKY. Good morning, Chairman Crapo, Ranking Member Brown, Members of the Committee. Thank you for the opportunity to testify today. My name is Tim Mislansky, and I am the chief lending officer for Wright–Patt Credit Union in Beavercreek, Ohio, as well as the president of our credit union service organization, myCUmortgage. I am also the Chair of the Credit Union National Association's Housing Subcommittee, on whose behalf I testify today.

Wright–Patt Credit Union has approximately $3.6 billion in assets and proudly serves over 330,000 members. We operate primarily in Dayton and Columbus and have the unique perspective of serving the urban core and the suburbs of those cities, as well as the surrounding rural areas. Last year, we helped over 4,600 families with $600 million in first mortgages and an additional 1,300 families with second mortgages. Our CUSO, myCUmortgage, provides a variety of mortgage services to nearly 200 credit unions, which range in asset size from $6 million up to $1 billion and are located across 25 States. Last year, we facilitated nearly 9,000 mortgages for $1.2 billion, making us one of the largest aggregators of credit union mortgage loans in the country.

As member-owned, not-for-profit financial cooperatives, many credit unions offer mortgages, and we represent an increasingly significant source of mortgage credit nationally. In 2016, credit unions originated over $140 billion in first mortgages, or 8 percent of the total market. It is clear that consumers are choosing locally owned and operated credit unions more and more to be their mortgage lenders. And as Congress considers housing finance reform, it is critical that credit unions have equitable access to a functioning, well-regulated secondary market and a system that will accommodate member demand for long-term fixed-rate mortgage products. Credit unions have been largely portfolio lenders, but with historically low interest rates and growing market share, we have found it increasingly important to sell long-term fixed-rate mortgages. Without a functioning secondary market, many credit unions would severely limit mortgage lending.

Servicing loans is also very important to credit unions for a number of reasons. Again, as member-owned cooperatives, we are driven by a desire to provide high-quality member service, and many credit unions are reluctant to sell the core function of servicing to others. This is especially important so that credit unions have the ability to make modifications to loans to keep borrowers in homes when they experience financial difficulties.

Because of the strength of this servicing relationship as well as the member-focused underwriting, the credit quality of credit union first mortgages held up remarkably well during the financial crisis, especially compared to that of other lenders, where net charge-off rates were as much as four times higher.

As we have testified in the past, CUNA supports the creation of an efficient, effective, and fair secondary market. To that end, CUNA supports housing finance reform proposals that are consistent with the following principles:

First, there must be a completely neutral third party independent of any mortgage-originating institution to ensure that no participant enjoys an unfair advantage and undue influence in the secondary market.

Second, the secondary market must be open to lenders of all sizes on an equitable basis, with access and pricing independent of lender volume.

Next, the entities providing secondary market services must be subject to appropriate regulatory and supervisory oversight.

The new system must be durable to ensure mortgage loans will continue to be made to qualified borrowers even in troubled economic times. This will require some kind of explicit catastrophic Federal guarantee funded by appropriate fees with significant private capital in a first-loss position. Any new housing finance system should emphasize consumer education and counseling to ensure that borrowers are able to remain in their homes.

The housing finance system must provide for predictable, affordable payments to qualified borrowers, including the 30-year fixed-rate mortgage. And conforming loan limits should be reasonable and take into consideration local real estate prices in higher-cost areas.

Credit unions should have the option to retain or sell the right to service their member mortgage loans, regardless of whether that loan is held in portfolio or sold in the secondary market.

And, finally, the transition from the current system must be orderly to prevent significant disruption to the housing market which would harm homeowners, potential homebuyers, the credit unions who we serve, and the Nation's housing market as a whole.

Thank you again for the opportunity to testify, and I look forward to your questions.

Chairman CRAPO. Thank you, Mr. Mislansky.

Mr. Hopkins.

STATEMENT OF JACK E. HOPKINS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CORTRUST BANK, N.A., MITCHELL, SOUTH DAKOTA, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. HOPKINS. Chairman Crapo, Ranking Member Brown, Members of the Committee, I am Jack Hopkins, president and CEO of CorTrust Bank, a $780 million asset bank in Mitchell, South Dakota. As a third-generation community banker, I am pleased to be here today on behalf of ICBA and nearly 5,000 community banks. ICBA strongly supports GSE reform, but it is critical to borrowers and the broader economy that the details of reform are done right.

Community bank mortgage lending is vital to the strength and breadth of America's housing market. Community banks represent approximately 20 percent of the mortgage market, but, more importantly, our mortgage lending is often concentrated in rural areas and small towns, which are not effectively served by large banks. For many rural and small-town borrowers, a community bank loan is the only option for buying a home.

CorTrust Bank was founded in 1930 and serves 19 communities in South Dakota and Minnesota, from Sioux Falls to rural communities. Today I would like to talk about my bank's mortgage lending and the importance of secondary market access.

CorTrust Bank has about a $590 million portfolio consisting of approximately 5,500 loans. About two-thirds of our mortgages are held by Fannie Mae and a smaller number are held by Freddie

Mac and by the South Dakota Housing Development Authority. The secondary market allows me to meet customer demand for fixed-rate mortgages without retaining the interest rate risk these loans carry. As a small bank, it is not feasible for me to use derivatives to manage the interest rate risk. Selling into the secondary market frees up my balance sheet to serve customers who prefer adjustable rate mortgage loans, as well as small business and agricultural loans, which play a vital role in our community.

ICBA's approach to GSE reform is simple: Use what is in place today and working well and focus reform on aspects of the current system that are not working or that put taxpayers at risk. ICBA has developed a comprehensive set of secondary market reform principles.

First, the GSEs must be allowed to rebuild their capital buffers. Though Fannie Mae and Freddie Mac have returned to profitability, the quarterly sweep of their earnings to the Treasury has seriously depleted their capital buffers. Absent a change in policy, they are on track to fully exhaust their capita by year end. A draw from the Treasury could trigger a market disruption. This self-inflicted crisis can and must be avoided. While Congress debates reform, the FHFA should protect taxpayers from another bailout. ICBA urges FHFA to follow HERA and require both GSEs to develop and implement a capital restoration plan.

Second, community banks must have equal and direct access. We must have the ability to sell loans individually for cash under the same terms and pricing available to larger lenders.

Third, there can be no appropriation of customer data for cross-selling of financial products. We must be able to preserve our customer relationships after transferring loans.

Fourth, originators must have the option to retain servicing rights at a reasonable cost. Servicing is a critical aspect of the relationship lending business model vital to community banks.

Finally, an explicit Government guarantee on GSE–MBS is needed. For the market to remain deep and liquid, Government catastrophic loss protection must be explicit and paid for through GSE guarantee fees priced at market rates. This guarantee is needed to provide credit assurances to investors and will sustain robust liquidity even during periods of market stress. Without these principles, we could see further consolidation of the mortgage market.

Any version of reform that effectively transfers the assets, infrastructure, or functions of the GSEs to a small number of mega firms could devastate the housing market in thousands of small communities and put our financial system at risk of another collapse.

The current system works very well today for lenders of all sizes and charters. I urge lawmakers to use caution when evaluating major structural changes to the GSEs or their elimination. We must not disrupt this very liquid market.

To conclude, ICBA supports housing finance reform so long as it is crafted to maintain access for small lenders, as stated in the title of this hearing, not merely on paper but in the real world.

Thank you again for holding this hearing and for the opportunity to testify.

Chairman CRAPO. Thank you, Mr. Hopkins.

Mr. Purvis.

STATEMENT OF CHUCK PURVIS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, COASTAL FEDERAL CREDIT UNION, RALEIGH, NORTH CAROLINA, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERALLY INSURED CREDIT UNIONS

Mr. PURVIS. Good morning, Chairman Crapo, Ranking Member Brown, my Senator from North Carolina, Senator Tillis, and Members of the Committee. My name is Chuck Purvis, and I am testifying today on behalf of NAFCU. I currently serve as the president and CEO of Coastal Federal Credit Union in Raleigh, North Carolina. I thank you for the opportunity to appear before you today to talk about the important issue of housing finance reform.

At Coastal, we have been offering mortgage loans for 40 years. Until 2008, Coastal held most of our mortgages in portfolio. As demand grew and long-term interest rates fell, we began to work with Fannie Mae to sell many of our loans into the secondary market. Without the GSEs, our capacity to lend in our communities would be outstripped by demand. Our ability to sell loans ensures liquidity, mitigates our long-term interest rate risk, reduces concentration risk, and keeps rates competitive. If not for access to the GSEs, our capacity to meet local demand would be greatly diminished. Consumers would suffer from higher rates and fees, more stringent credit requirements, and overall fewer options. A viable secondary market is vital to our success as a community lender.

As a credit union CEO, every day I go to work focused on our members and how Coastal can help put more money in their pockets. For many, home ownership is what they aspire to, and Coastal is with them every step of the way.

NAFCU welcomes the thoughtful and practical approach the Committee is taking on housing finance reform. We have been active in the housing reform debate and do not believe any proposals discussed in previous Congresses adequately protect the needs of community-based lenders.

NAFCU believes there are certain housing finance reform principles that are important to credit unions and should be considered in any reform effort. I outline these in detail in my written testimony, and I would like to highlight a few of the key points here today.

Of utmost importance, NAFCU believes that a healthy, sustainable, and viable secondary mortgage market for credit unions must be maintained. To achieve this, credit unions must have guaranteed access to the secondary mortgage market. We believe that efforts to fund any new system must be done in a way as to limit the cost to smaller lenders and not be a barrier to access.

NAFCU wants to stress that it is critical that large institutions not be given control of the market. Their market dominance would have negative consequences for smaller lenders. Congress must ensure that does not happen in a reformed system.

We believe that any new system must recognize the high quality of credit union loans with a fair pricing structure. Because credit unions originate a relatively low number of loans compared to others in the marketplace, we do not support a pricing structure based on loan volume, institution asset size, or any other issue that will disadvantage our member owners. As such, credit unions should have access to pricing that is focused on quality, not quantity.

NAFCU believes that there should be a continued role for the U.S. Government to issue an explicit guarantee on the payment of principal and interest on mortgage-backed securities. The explicit guarantee will provide certainty to the market, especially for investors who will need to be enticed to invest in mortgage-backed securities and facilitate the flow of liquidity through the market. We do not think that the GSEs should be fully privatized at this time.

A transition to a new system should also be as seamless as possible. Credit unions should have uninterrupted access to the GSEs or their successors and the secondary mortgage market as a whole, in particular through the cash window and small pool options.

Our partnership with Fannie Mae is critical to Coastal's mortgage lending function. Our use of Fannie Mae's Desktop Underwriter on all mortgage loans that we originate ensures conformity and consistency across our portfolio, whether we sell the loan or not. Access to such technology must be preserved in any reforms.

Finally, any new housing finance system must ensure credit unions can retain servicing rights to loans they make to their members. Our members turn to us for lower rates and fees and because they want to work with an organization they trust and know will provide them with high-quality service. At Coastal, we retain servicing rights on all of our loans. This was especially beneficial during the financial crisis as it allowed us to work with members on their loan to keep them in their home.

In conclusion, credit unions exist to provide provident credit to their members. It is vital that credit unions continue to have legislatively guaranteed access to the secondary market and fair pricing based on the quality of their loans.

Thank you for the opportunity to provide our input on this important issue, and I welcome any questions that you may have.

Chairman CRAPO. Thank you, Mr. Purvis.

Mr. Hunt.

STATEMENT OF WES HUNT, PRESIDENT AND CHIEF EXECUTIVE OFFICER, HOMESTAR FINANCIAL CORPORATION, GAINESVILLE, GEORGIA, ON BEHALF OF THE COMMUNITY MORTGAGE LENDERS OF AMERICA

Mr. HUNT. I want to first thank Chairman Crapo, Ranking Member Brown, and the Committee for the opportunity to testify, and a special thank you to my Senator, Senator Perdue of Georgia. I am the owner of Homestar Financial. We are headquartered in Gainesville, Georgia, and have been in business since 2002. We are the State's largest originator of FHA purchase and rural housing loans, a major provider of VA loans for our veterans and active servicemembers, and a Ginnie Mae issuer. We also sell directly to Fannie and Freddie. We survived the downturn by originating well-documented loans and underwriting them carefully.

I am here for CMLA, which represents both community banks and mortgage bankers, like my own company. CMLA was formed to give small lenders a voice in a trade group that does not include large banks.

CMLA is also part of the Main Street GSE Coalition, a policy group made up of small mortgage lenders, home builders, civil rights groups, and consumer groups. The coalition recently issued a set of Common Principles for GSE reform.

Addressing the topic today, we know why the GSEs went into conservatorship. The HERA legislation in 2008 cured many of the prior GSE defects, and the Qualified Mortgage Rule addressed risk from lax standards and recklessly designed products. I address these issues in more detail in my written testimony.

What remains to be done is to make the level guarantee fee permanent, as it expires in 2021, and apply this same principle to up-front risk sharing. We need a permanent Federal backstop on Fannie and Freddie, and the regulator must set strong capital. When Fannie and Freddie reach these capital standards, they should be released from conservatorship. But a fix must match the problem needing repair and not create new ones.

Small lenders fear that a large, untested, complex housing finance reform plan will do two things that will be a detriment to the housing market:

Number one, create marketplace uncertainty that raises cost for homebuyers, small lenders, and constricts mortgage lending;

Number two, wittingly or unwittingly gives greater market pricing power to Wall Street and large banks at the expense of those of us on Main Street.

GSEs should be regulated closely, as they are now, but capitalized properly, as they currently are not. We agree with the prudential regulator that capital is needed now, and we all have a common interest in ensuring that the housing and banking bailouts of 2008 do not occur again.

Part of the past problem with the recklessly designed products—excuse me. Part of the past problem with the GSEs was too little capital. Today they have even less than what they had in 2008. This makes no sense on Main Street.

Well-capitalized GSEs will be able to balance underwriting standards and mortgage risk and fulfill affordable housing obligations. Well-capitalized GSEs that treat all lenders equally in terms of fees and up-front risk sharing will avoid concentrations of risk and ensure a flow of affordable mortgage money to the families we serve in the Southeast and my fellow CMLA members serve throughout the country.

Economic growth remains slow in the U.S., and housing and housing construction has certainly underperformed. We need to move forward, especially as the largest ever population group, the echo boomers, are now of age to purchase their own homes. In the history of the country, we have never seen a giant new generation like this. Home ownership is already at a half-century low. For a supply of affordable mortgage money for this generation, we need a safe secondary market independent from the reach of the biggest banks.

I am also a member of the MBA, a great organization, but on this crucial topic of GSE reform, I am aligned with CMLA and other members of this panel. Main Street lenders did not cause the downturn. We are committed to the continued origination of quality loans while diligently working to help individuals and families realize the dream of home ownership. Please consider the steps I have outlined in my testimony to make this possible.

Thank you.

Chairman CRAPO. Thank you, Mr. Hunt.

Mr. Giambrone.

STATEMENT OF WILLIAM GIAMBRONE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, PLATINUM HOME MORTGAGE, ROLLING MEADOWS, ILLINOIS, AND PRESIDENT, COMMUNITY HOME LENDERS ASSOCIATION

Mr. GIAMBRONE. Chairman Crapo, Ranking Member Brown, and Members of the Committee, it is a privilege and honor to testify before you today. I am Bill Giambrone, president of Platinum Home Mortgage Corporation, based in Rolling Meadows, Illinois. I appear before you today as President of the Community Home Lenders Association (CHLA). CHLA is a group of small and mid-sized independent mortgage bankers, also known as "IMBs", committed to advocating for affordable, accessible single-family mortgages for families in communities where we lend. None of our members are taxpayer-backed depository institutions.

I am here to explain from our perspective why it is important for the Committee to design a GSE reform bill in ways that ensure full and equitable small lender access to the secondary market.

Since the 2008 housing crisis, we have seen large banks significantly retreat from mortgage lending. We have provided data in my testimony to show that IMBs have filled the access to the mortgage credit void that banks left.

While consumers complained about lack of responsiveness from mega servicers, IMBs provided personalized service to distressed borrowers in our local communities. So what should we do next?

CHLA worked with affordable housing and other small lender groups to develop the GSE reform principles as part of the Main Street GSE Coalition. We appreciate that you entered that document in the record at the last hearing.

My written testimony also includes CHLA's detailed GSE reform plan, a plan that identifies significant taxpayer reforms that have already taken place, and encourages FHFA to continue them. In addition, FHFA should take two important steps which we encourage Congress to support.

First, FHFA should allow Fannie and Freddie to retain a modest capital buffer. We believe $10 billion each is the appropriate level. This would address what FHFA Director Watt called their "greatest risk," their lack of capital.

Second, FHFA should develop and release a capital restoration plan detailing how Fannie and Freddie could best recapitalize and exit conservatorship. Congress would only benefit from having such a plan or road map.

The CHLA plan also includes details on how congressional GSE reform should be done. The overriding objective is to ensure broad access to mortgage credit for all qualified borrowers nationwide while protecting taxpayers. We know that the well-qualified mortgage borrowers in large urban areas will be served. The question is whether families living in rural or other less populated areas will have real access to mortgage credit and whether low- to moderate-income borrowers will be served. Small lender access is critical to achieving this goal.

My testimony lists four recommendations for preserving small lender access to the secondary market:

First, preservation and recapitalization of Fannie and Freddie using a utility model. This is necessary so the GSEs can continue their role of facilitating a secondary market for small lenders.

Second, no new charters should be authorized to carry out functions that Fannie Mae and Freddie Mac presently carry out. The likely impact of authorizing new charters would be to grow the Government, increase risk of taxpayer bailout by creating more new "too big to fail" entities, increased regulatory risk because regulators may not be able to keep up with the complexities of the numerous competing entities, and undermining the utility model concept.

FDIC Vice Chairman Thomas Hoenig recently noted that the four largest banks have grown from 14 percent of total industry assets in 1992 to 42 percent today, and that they "dominate the industry and increasingly dominate our economy." We do not want this to happen to the mortgage industry. We believe it will happen if charters are granted to big banks or other "too big to fail" entities like investment banks or insurance companies.

Opening the door to new charters also raises longstanding concerns about vertical integration. There is no way to ensure that new charters will not be influenced or controlled by the "too big to fail" institutions, even with only a small ownership interest in the new entity.

Third, all risk sharing should be done as back-end risk sharing. Up-front risk sharing could create significant risks for small lender access and could result in practices such as volume discounts or vertically integrated investment banks dealing exclusively with their bank lending affiliate. The objectives of risk sharing can be fully accomplished by exclusively doing it by back-end risk sharing.

Finally, pricing, underwriting, and variance parity. Previous legislative language had language requiring GSE parity. We agree with this. We also believe equitable treatment for small lenders should extend to other areas, such as underwriting variances, reps and warrants, and any proxy for price advantages.

I appreciate the opportunity to speak before you today, and I look forward to questions. Thank you.

Chairman CRAPO. Thank you, Mr. Giambrone.

I will begin the questioning. As I mentioned in my opening statement, there are a number of principles of housing finance reform that I believe share bipartisan support, and I would like to just go through—there are about five or six I want to read through here. These are general principles, and I expect that there is broad agreement on them. So what I am going to do is just read these principles and ask you if there are any of you who have any concern or would want to make any clarifications about the principles that I read. And if not, that is fine. I have got other questions I want to go on to.

The first principle is we need to preserve the 30-year fixed-rate mortgage and the TBA market.

Second, we need multiple levels of taxpayer protections, including strong, robust, loss-absorbing private capital at any guarantors that sit in front of the Government guarantee.

Third, private capital rather than taxpayers should bear noncatastrophic credit risk.

Fourth, we must have an orderly transition that utilizes existing market structure, where possible, and minimizes market disruptions.

Fifth, the current conservatorships are unsustainable, and Congress must find a long-term solution.

And then, finally, we need a level playing field to ensure that small lenders can access the secondary market equitably.

I realize those are broad statements, but is there anybody who wants to issue some clarification on those? Are those principles acceptable to each of you? All right. I am taking that as a yes.

Mr. PURVIS. Yes.

Chairman CRAPO. All right. Thank you.

Mr. MISLANSKY. Senator?

Chairman CRAPO. Yes, Mr. Mislansky.

Mr. MISLANSKY. I believe you may have said—and so I would ask you if you would clarify that—the private capital should take the catastrophic losses. Is that accurate? I think it was third principle you were at.

Chairman CRAPO. Yes, it should bear the noncatastrophic credit risk.

Mr. MISLANSKY. The noncatastrophic. Thank you. So I would agree with that.

Chairman CRAPO. All right. Then let me go directly to you, Ms. Hughes. In your opening testimony, you stated that you reject the approach of recapitalizing the GSEs and releasing them back into the private market with limited changes. Can you explain a little more about that and why you feel it is critical that Congress pass GSE reform?

Ms. HUGHES. In the current such with them under Government conservatorship, they have—we have essentially stymied innovation and lending. Community banks, we rely upon the secondary market. We rely upon that path to serve our customer base and deliver those loans to the market. And under the current structure, neither of the GSEs—speaking of Freddie and Fannie—are operating in a path to grow and improve the mortgage market base. And so bringing them back to a position where they can continue to operate and function as a partner in the industry would be vital.

Chairman CRAPO. All right. Thank you very much.

And, Mr. Mislansky, you mentioned in your opening testimony that your credit union makes mortgage loans to consumers and also owns a firm that serves as an aggregator of mortgage loans. Can you describe those two channels of accessing the secondary market for small institutions? And then what are some of the factors that a lender considers in deciding how to access the secondary market?

Mr. MISLANSKY. Certainly. So the credit union has what I would refer to as a typical retail production. We have loan officers on staff who meet with members, take their applications, help them through the process, educate them, and ultimately help them get to the closing table so that they can become a homeowner or save money with a refinance.

The subsidiary that the credit union owns, myCUmortgage, we refer to it as an "aggregator," and what we do is we provide back-office services to credit unions. I mentioned, for example, in my written testimony that we have one $30 million institution that is a customer or credit union client of ours, TopMark Federal Credit Union, which is in Lima, Ohio. Again, they are a $30 million institution, so certainly by any standards they would be considered small. They originate $15 to $16 million most years in mortgages. That is a lot of originations for an institution that small. And what we do with them is, again, we help them process and we help them underwrite, help them close, and then we buy their production. They do not have the capacity to sell those loans direct—or to hold those loans on their balance sheet or to even maybe go direct to Fannie Mae or to Freddie Mac.

So while they need small lender access to the secondary market, they have chosen the manner of going through an aggregator such as us and leveraging the expertise that we bring to the table to help them be able to achieve the same concept of going direct to a Fannie Mae or a Freddie Mac.

Chairman CRAPO. All right. Thank you.

Senator Brown.

Senator BROWN. Interesting, thank you. I was not aware of that.

I will start with Mr. Mislansky, and then I have a question for everybody. With Wright–Patt's footprint across several types of communities, help us understand how access to the secondary market helps you serve communities or borrowers that are typically ignored by the larger national lenders.

Mr. MISLANSKY. So there are multiple ways that occurs. One of the ones that I believe is unique to us in our market, we serve the core of Dayton. We have several branches, what we call "member centers," in inner-city Dayton or in the near-inner city. And in those communities, the home values are relatively low. You can buy a home in certain markets in Dayton for $40,000 or $50,000. That might be surprising to those people in the District where, you know, you would need half a million dollars to buy a home, or upwards. But we make loans without any loan limits on the downside, and what I mean by that is we do not have a minimum loan amount. So if you are a member of our credit union and you want to buy a $40,000 home, we will still make a loan to you, where many lenders will have larger limits—or minimums in place, and they use those minimums—those minimums prevent urban areas from in some ways revitalizing.

So what the secondary market——

Senator BROWN. And I assume rural areas in, say, northern Miami County or places that the homes are not quite as inexpensive as inside of Dayton——

Mr. MISLANSKY. Correct.

Senator BROWN. ——but pretty inexpensive by national standards.

Mr. MISLANSKY. By national standards, yes. Those rural homes, $60,000, $70,000, $80,000 homes. And what we do to help manage the credit risk, to help manage the interest rate risk, and to help manage the liquidity risk is we sell those loans in the secondary market to either Fannie Mae or we are also a Ginnie Mae issuer.

Senator BROWN. OK. Helpful. Thank you.

Let me ask a question of—I will put two questions out that, Ms. Hughes, if you would start and just go down the line. GSEs in the past used volume discounts to attract business from lenders such as Countrywide and Wells Fargo, with large origination volumes, as you know. The two questions are this, and I will just work down the group. Is equitable pricing for small lenders an essential part of the system? And does inequitable pricing impact mortgage access for your customers?

Ms. HUGHES. Yes to both. In the past, it was a competitive disadvantage for us to have pricing against the larger institutions. You had more favorable pricing than we could obtain. And equitable pricing across the board is vital to continued success.

Senator BROWN. OK. Thank you.

Mr. Mislansky.

Mr. MISLANSKY. Senator, again, I would agree that the answer is yes to both. And while the competitive issues are certainly there, I think the other issues to take into account are when volume pricing is provided to, whether it is a lender or to any type of entity, what you are trying to do is to gather more volume, and if the entity can earn more revenue because they are sending in more volume, does that create an opportunity for unintended consequences such as you take short cuts on making the loans? And maybe the credit quality is not as strong, or maybe the underwriting is not as strong. And I think that is some of what we saw during the financial crisis when lenders that no longer exist today, such as a Countrywide or a Washington Mutual were receiving volume discounts, but the quality of their paper was not there.

Senator BROWN. Thank you.

Mr. Hopkins.

Mr. HOPKINS. It definitely put us at a competitive disadvantage, but I think many times we found that the rates were fairly similar, so it was really just a transfer of profits to the large institutions from the GSEs. And so I felt that they were pocketing the money at the expensive of the borrowers.

Senator BROWN. OK. Thank you. Good comments.

Mr. Purvis.

Mr. PURVIS. We think it is important for the mortgage market in the U.S. to have local community-based lenders, regardless of whether it is a credit union, a community bank, a community lender or otherwise. And the only way that will happen is if the pricing is equitable irrespective of size and production volumes of the sellers.

Senator BROWN. OK. Mr. Hunt.

Mr. HUNT. We certainly believe that pricing equality is important and must be maintained, and it certainly would be a barrier to entry even for a new lender if they come in with a disadvantage to pricing. It is going to be even more difficult for them to grow their business. So when you put an advantage out there to a larger lender who already has a foothold in a marketplace and you have a new competitor or new lender coming in, an emerging lender that is growing, such as an independent banker, as my company is, you put that new company at a further disadvantage so you are going to further disadvantage the consumers. There is going to be less access because you are not going to have new lenders coming into the marketplaces easily.

Senator BROWN. Thank you.

Mr. Giambrone.

Mr. GIAMBRONE. The short answer would be yes to both. I would expand upon it saying that many times they do pass it on in terms of a competitive disadvantage and other times they do pocket the difference. I think the big difference comes from the consumer wanting us many times to retain the loan, and if we are at a price disadvantage, we are unable to do that.

For example, last year, when a large entity had some issues with cross-selling, we had many of our customers ask us not to sell their loans to aggregators. And if the pricing is disadvantaged, we would not have that opportunity. So those folks would be forced into that scenario. So that was a big variable.

And the other one, just to add to it, would be this is also what I mentioned in my testimony, risk sharing, that is another way that it could be—if it is up-front risk sharing, not back-end, it could be manipulated in the form of price advantages up front.

Senator BROWN. Thank you.

Chairman CRAPO. Thank you.

Senator Tillis.

Senator TILLIS. Thank you, Mr. Chair. Welcome to everybody. A special welcome to a constituent and hopefully a voter.

[Laughter.]

Senator TILLIS. Down in North Carolina.

Mr. Purvis, I want to welcome you. I want to ask you a question. I thank you for your time this morning. I want to talk specifically about what things this body should consider with respect to affordable housing in the context of GSE reform. And in the time allowed, I would like for you to talk a little bit about what we discussed with the work that you are doing with Habitat for Humanity over in the Raleigh area.

Mr. PURVIS. Sure. Thank you. We need to try to expand housing and home ownership opportunities to as broad a sector of the population as we can, and we certainly agree with that goal.

A couple of things we are doing in our market, we have had a 100-percent first-time homebuyer program since the late 1990s, and that has been very successful, delinquencies and losses very low. We work very closely in providing home financial education at the front end of the process. And so today we find new individuals and couples who are struggling to save money for a downpayment because of student loan debt, and so we are able to meet their desire for home ownership through that program.

Then on the low-income front, we established a partnership with Habitat Wade County about 18 months ago to provide $6 million in 2-percent mortgages which does two things: it will lead to the construction of 60 affordable homes, and then put 60 low-income families into those homes. So we are trying to do what we can in the local community to expand access to both home ownership and affordable mortgages to the low-income community.

Senator TILLIS. What do we need to be—and this would be to anybody who would like to add to it. What should we be particularly sensitive to that would, within the context of the reform discussions we are having, that would either be particularly helpful or harmful to some of the things you are already doing?

Mr. PURVIS. I will answer that. The operational relationship between us and Fannie Mae to the securities market works very well today. It has taken decades to build. It is very efficient. Let us make sure that we do not break that or lose that in our efforts to reform the system. Otherwise, it will be disruptive to the market.

Senator TILLIS. Yes, sir?

Mr. MISLANSKY. Senator, I think the other thing that is sometimes missed with the discussion about Fannie and Freddie is the standardization that the GSEs brought to the mortgage market, the uniform residential loan application. All of us as lenders use that same application. All of us either use Desktop Underwriter, as Mr. Purvis mentioned, or Freddie Mac's competing product. There are standardizations about the documents that are needed to close a loan—to record a loan and to close a loan. All of those aspects are important to creating a commodity product in the United States that goes into mortgage-backed securities.

And so as changes are considered with the secondary market, I think it is important that the standardization and the assets that—the people side and the technology side that Fannie and Freddie have built are considered and how to be maintained.

Senator TILLIS. Just one question in my time remaining, and I have got a lot that we will probably submit for the record so that we can get more feedback. But I would like the market-based rationale for an explicit Government guarantee. I think there was at least in one of your testimonies you think that that is very important. So for those who may differ, give me the market-based rationale for that explicit Government guarantee.

Mr. HOPKINS. The market-based guarantee, the explicit guarantee is obviously going to help keep the rates low for the homeowner on a going-forward basis because——

Senator TILLIS. The Government guarantee.

Mr. HOPKINS. The Government guarantee standing behind the MBS securities, because without that guarantee the rates would be higher to the consumers. You know, we are talking about being the final line of defense as really that catastrophic type of insurance in the guarantee from the Government.

Senator TILLIS. So the overall return is the rationale—or the overall return and market activity is the rationale for the Government guarantee.

Mr. HOPKINS. Keeping it affordable, I think it is part of the affordability that you are looking for, for particularly first-time buyers to get into the market.

Senator TILLIS. OK. Thank you.

Mr. Chair, I yield back my 12 seconds.

Chairman CRAPO. Thank you, Senator Tillis.

Senator Menendez.

Senator MENENDEZ. Well, thank you, Mr. Chairman. I am running between hearings here. Thank you all for your testimony. I am pleased to see the Committee highlighting the importance of access for small lenders, and I think you all represent community-oriented institutions working to increase affordable options for homeowners and borrowers in cities around the country.

In reading each of your statements, a common theme emerges in favor of targeted precise reforms over wholesale restructuring of the system. I think that is a fair statement to make. And one important benefit of the current system is that it allows community banks and lenders to sell their loans to the GSEs through the cash window but retain the servicing rights to the loans, and in doing so preserve the relationship with the borrower.

So why is it important for borrowers that lenders have the ability to retain their servicing rights? And I hope that up to anyone who wants to speak to it.

Mr. GIAMBRONE. Senator Menendez, a great question, and I think in my testimony, what I had mentioned earlier, many times the customers want the local lender. It is a matter of service, right? If they see us in the store or at the ball field and there is a little bit of a difference if we are unable to. So, for example, when there was big pricing disparity, most of our loans would be sold released, and at this point we are able to retain more because the pricing differential is not as wide as it was. So a big factor is simply just the consumers like it when it is a local lender servicing their loan.

Senator MENENDEZ. Anyone else? Mr. Hopkins.

Mr. HOPKINS. Senator, from my perspective, we do servicing of mortgage loans, and it allows us to keep our customers from being cross-marketed by some of the larger firms. If we were to sell to some of the other firms, we might have had accounts opening that they were not aware of, et cetera. And we look at it—they can walk into any one of our branches and ask any one of our people a question, and they can pull it up in front of them. We have the local service in all of our local branches. So rather than calling a 1–800 number—I call it "1–800-who-cares"—we are there for them. We are there at the individual branches.

Senator MENENDEZ. Thank you.

Mr. Purvis.

Mr. PURVIS. Most of our mortgage borrowers have a lot of other account relationships with us. They have their checking account here. They have a savings account. They have an IRA. They have a car loan. They have a credit card. And so they can contact us with servicing issues, questions across the entire relationship with us. It would be very difficult to have to say, "I am sorry. I cannot answer your servicing question on your mortgage because someone else is servicing it." So for us, it is about being responsible for the entire relationship we have with that member.

Senator MENENDEZ. Those are fine answers.

Let me ask you, and maybe just one or two of you could answer in the time I have, what challenges would your institutions face in assisting borrowers that fall behind on their mortgage, for example, if various new guarantors or entities establish disparate loan servicing standards. Mr. Hopkins.

Mr. HOPKINS. We do servicing for, as I said, Fannie and Freddie and our South Dakota Housing Development Authority, and they do have different requirements for what we can and cannot do with the borrowers. For instance, South Dakota Housing is a little more restrictive than Fannie Mae is with their programs and being able to work with them. So just creating the complexity of a lot of different servicers, it gets to be difficult for our staff to keep ahead of it.

Senator MENENDEZ. Let me ask a question of all of you, and if you can give me a simple yes or no answer, I would appreciate it. Would you agree that—and I want to follow up on the Ranking Member's questions. Would you agree that competitive pricing for loan sales with a securities option is necessary for small lenders to continue accessing the system? Yes or no.

Ms. HUGHES. Yes.

Mr. MISLANSKY. Yes.

Mr. HOPKINS. Yes.

Mr. PURVIS. Yes.

Mr. HUNT. Yes.

Mr. GIAMBRONE. Yes.

Senator MENENDEZ. That is good. We do not get that type of unanimity around here.

[Laughter.]

Senator MENENDEZ. Would you agree that, in order to facilitate this competitive pricing, we need a guarantor or entity that can pool costs across the market and that has a duty to serve all lenders? Yes or not.

Ms. HUGHES. Yes.

Mr. MISLANSKY. Yes.

Mr. HOPKINS. Yes.

Mr. PURVIS. Yes.

Mr. HUNT. Yes.

Mr. GIAMBRONE. Yes, but not more than two.

Senator MENENDEZ. Would you be concerned about the workability and accessibility of a system in which so much of the credit risk has been transferred on the front end that there is inadequate revenue remaining to pool costs and serve a wide range of lenders? Yes or no.

Ms. HUGHES. Yes.

Mr. MISLANSKY. Yes.

Mr. HOPKINS. Yes.

Mr. PURVIS. Yes.

Mr. HUNT. Yes.

Mr. GIAMBRONE. Yes.

Senator MENENDEZ. I am going stop at three for three, so thank you, Mr. Chairman.

[Laughter.]

Chairman CRAPO. You were on a roll.

Senator Scott.

Senator SCOTT. Thank you, Mr. Chairman. Thank you to the panel for being here this morning and answering a lot of questions.

From my perspective, home ownership is such a big part of the American dream, and when you think through the net worth of the average American, what we come to conclude is that your equity in your home accounts for a significant portion of your net worth. That means that those folks who have been trapped out of home ownership have a significantly smaller net worth, minority communities to speak specifically. And in many ways, volume discounts by the GSEs could work against access to home ownership, particularly when so many small banks and credit unions spend a lot of time investing in their members, to understand and appreciate the unique lives of those members. It is an intimate relationship. I served on a credit union board for about 7 years, and so I have great affinity for our credit unions.

My question is: How do credit unions and community banks get squeezed out under volume discounts? For the panel.

Ms. HUGHES. Again, it comes back to a pricing disadvantage, and if you have those larger pricing, the larger institutions can either undercut you, they can make more profits, it gives them the opportunity to go out and do more targeted marketing. And the inability for us to compete in that space makes us a little uncompetitive.

Senator SCOTT. Thank you.

Anybody else?

Mr. MISLANSKY. Senator, I might try to answer the question a slightly different way, not in terms of price advantage and what the GSEs would allow in terms of they pay more to one lender than another, but there was a practice that used to be in existence where variances were given under the master service contracts. And what that would mean is that Fannie or Freddie would have their standard set of rules by which they would buy a loan. But they may negotiate a special variance with another lender to either do something or not do something.

So in my market, one of the lenders had negotiated a variance where they did not require title insurance on loans that were sold to Freddie Mac, I believe it was. And so what happened is that that lender was able to have a substantial price advantage in the marketplace by—if a member compared a Wright–Patt loan versus this institution, they saved quite a bit of money. And title insurance, granted, does protect the lender. It created that sort of advantage.

So it is not just how much they will pay for the loan. I think it also includes the rules that you can sell loans by.

Senator SCOTT. Anybody else?

[No response.]

Senator SCOTT. On the flip side, I am focused on encouraging sustainable home ownership over simple homebuyership. One way to do so is the FHFA updating the accepted credit scoring models at the GSEs. If a family pays their utility bills or their phone bills on time for a decade, it ought to count toward their ability to have a home. I will go to Mr. Purvis. Why is it important that the model be updated? And who benefits from the capture of this new data?

Mr. PURVIS. So the FICO models used by Fannie and Freddie are decades old. They have certainly been updated over time, but they are still based on essentially a loan repayment history and then an "I gotcha" because you had a delinquency or collections item or so forth.

There are new data sources that capture payment history on cell phone bills, utilities, rent, et cetera, that are not being used in the determination of creditworthiness by the GSEs, and we think it is very important for them to begin updating their credit models to take advantage of those other sources, which we think will widen the net of folks who become eligible for conforming mortgages through the GSEs.

Senator SCOTT. Thank you, sir.

Mr. HOPKINS. We do use some of the other scoring models for our credit card part of our program, and they do work well. However, I would say that if we are going to on the mortgage side, we do need some time to make sure we can validate the data.

Senator SCOTT. Absolutely.

Mr. HOPKINS. Because that will be key to making it work properly.

Ms. HUGHES. Mr. Scott, we actually manually underwrite loans, consistently deliver these loans to the market. So for those borrowers that have alternative credit sources, we already do that. That path already exists. Adding more credit scoring models to the market would require some data validation, so some time periods it adds cost. It adds cost to the borrowers. And if you have lenders who already have that ability, we can already deliver those loans to Freddie Mac and Fannie Mae. We can deliver them and insure them under FHA/VA. The path already exists.

The issue comes into play that pricing is usually different if you have a manual underwrite. So if the pricing were equitable, the systems are already in place. The systems that are in place work for the lenders who are willing to do the work for the borrowers.

Senator SCOTT. Thank you very much. Ranking Member.

Senator BROWN [presiding]. Senator Warren.

Senator WARREN. Thank you, Mr. Chairman. I want to thank you all for being here.

We cannot have a thriving mortgage market if small lenders do not have access and the big guys do. You know, it would produce a competitive imbalance that will drive smaller guys out of the market, and it was one of my primary concerns the last time we were considering housing finance reform. So I am very glad we are on this topic now. I think it is critically important.

But even if we agree that small lenders and big lenders should have equal access to the secondary market, it leaves an important question, and that is, what do we have to do to provide that equal access to the secondary market? And, Ms. Hughes, you addressed some of this in your written testimony, so I want to follow up on this.

As Senator Brown and Senator Scott both noted, one of the major issues about access for smaller lenders is volume discounts when the GSEs would give bigger lenders a better price on a bunch of loans than a small lender would get for a single loan. So how would you propose that Congress fix that problem, Ms. Hughes?

Ms. HUGHES. Well, I think by simply removing the volume discounts. In addition to paying up for bigger—you know, bigger blocs of loans with larger institutions, historically they would also pay up for low- to moderate-income loans.

Senator WARREN. So, basically, you are just saying let us bar any secondary market entities from offering a volume discount.

Ms. HUGHES. From offering volume discounts, yes.

Senator WARREN. And that would help level the playing field.

Ms. HUGHES. Yes, correct.

Senator WARREN. Now, another issue that you all have raised is one, as I read it, of customer service, and you write that it is not just pricing but that GSEs—other policies were geared toward higher-volume lenders, and the GSEs showed little interest in working with smaller, low-volume banks. So how would you propose to solve that problem?

Ms. HUGHES. I also think that the GSEs need to give all partners in the industry the same level of service.

Senator WARREN. Yeah, but you want changes in the law. So I take it what you are saying is you want Congress to mandate that any secondary market entity treat all lenders equally.

Ms. HUGHES. Correct.

Senator WARREN. OK, good. And then a final issue is whether larger lenders can operate in both primary and secondary markets, that is, whether or not they can both originate mortgages and be involved in purchasing and securitizing mortgages. And I think, Mr. Giambrone, your organization has raised concerns about this issue. So how would you propose that Congress address it?

Mr. GIAMBRONE. Well, that is a great question, and I think in my testimony I explained that the main way to address it is to leave the entities the way they are today, make it a utility model, and I think there is a consensus on a utility model, where it is regulated what they are allowed to charge that is equal for all.

Senator WARREN. But I take it on the vertical integration point what you are really saying is that Congress should prohibit any vertical integration, that is, you have got to be in one space or the other but you do not get to be in both spaces in terms of origination.

Mr. GIAMBRONE. Correct. That is what we are saying, and I think the proposals that are on the fringe—I guess it is opening Pandora's Box, so to speak, if they can own a little percentage, but not a lot.

Senator WARREN. OK.

Mr. GIAMBRONE. And then you have a control issue, and it may not look like vertical integration but, in fact, it is.

Senator WARREN. But I get your point, and that is, your ideal would be just prohibit people from—or entities from operating in the primary and secondary market simultaneously.

Mr. GIAMBRONE. Correct.

Senator WARREN. Good. So I want to thank you all for your testimony. I support ensuring equal access to the secondary market for small lenders, and I think it is critical that we get the details right on what it is going to take to make that happen.

But I also want to highlight that ensuring equal access for smaller lenders involves Government intervention on pricing, on customer service, and on the types of entities that can compete in the marketplace. And many of my Republican colleagues support equal access for smaller lenders, and they seem perfectly happy to sign off on Government intervention to help small lenders. But then they turn around and oppose any form of Government intervention to help lower-income or minority borrowers. And I do not think you can have it both ways.

We need thoughtful Government intervention to make sure that the mortgage market works for both small lenders and for creditworthy low-income borrowers. So I want to see us working in both spaces at the same time. Thank you very much.

Thank you, Mr. Chairman.

Chairman CRAPO [presiding]. Thank you, Senator Warren.

Senator Heitkamp.

Senator HEITKAMP. Thank you, Mr. Chairman. I think a lot of discussion, and good discussion, and actually good consensus around this lane. But it is like everything else in Washington. We can sit here and yes, yes, yes, yes, yes, yes, yes, yes, yes, and then nothing happens. So we need to remain committed to actually taking that consensus and figuring out how we can build legislation and how we can bring certainty to small lenders.

And as you can imagine, North Dakota is a place where small lenders have thrived for many, many years, and, unfortunately, for many of my small community banks, they are basically priced out of the mortgage market by excess compliance costs, which is another whole issue beyond access to the secondary market.

So we are going to continue to have these conversations, but I want to—I do not want to recover—I do not want to plow over the same area—we say that in North Dakota, "plow"—plow over the same area that has been already tilled, but I do want to talk a little bit about duty to serve. In today's market, many lenders are facing challenges extending mortgage credit in some of the more rural areas of our State. We can talk about appraisals, and anyone who wants to weigh in on that, please do. Both Fannie and Freddie have released their public plans aimed at helping rural, and underserved markets get more access to the secondary market. And this is for everyone, and maybe just go through it quickly. Do you think that the new underserved market plans will be effective tools in helping small lenders in rural areas? I will start with you, Ms. Hughes.

Ms. HUGHES. Yes.

Senator HEITKAMP. Yes?

Mr. MISLANSKY. I am not substantially familiar with the plans, but from what I have read, yes.

Senator HEITKAMP. OK.

Mr. HOPKINS. I think it goes part way, but as your neighbor to the south, there is a lot of work to be done.

Mr. PURVIS. Yeah, I am not familiar with that plan.

Senator HEITKAMP. OK.

Mr. HUNT. I am not familiar with the plan either.

Mr. GIAMBRONE. Yeah, I think it is a good start, and I think it will help. It will need some tweaking as it evolves, but I think it is a good plan.

Senator HEITKAMP. It is critically important that we understand how this will operate, because as we are looking at legislating in this space, things that have been done in the regulatory sphere or in the implementation, if they are working, then we need to make sure that we do not take a step backwards.

How could housing finance systems increase accountability for helping small lenders in the rural part of our country? And maybe we will stick to the folks who actually have focused on rural lending, and we will start with you, Ms. Hughes.

Ms. HUGHES. You know, we are a rural area, but we really have not had an issue with affordability. Our issues do surround around appraisals, making sure we have timely appraisals coming in, making sure we have qualified appraisers, making sure we have appraisers who are not afraid to deal with the Freddie Mac and Fannie Mae rules. But as far as access to customers, we have not had a huge issue with that.

Mr. MISLANSKY. So at our institution that is the subsidiary, we use the USDA's Rural Development Program quite a bit, and we are one of the larger lenders, at least in the State of Ohio, in terms of making that product available to help people become homeowners. So maintaining that sort of product would be critical for us to continue serving members in the rural areas.

Mr. HOPKINS. We have a few counties within our State where we are the only mortgage lender, and I think some of the complexities and the compliance laws have driven many of the lenders out of the market. And I think that is part of the issue we are dealing with here, is it has just gotten to be a very, very complex market. Some of the appraisal rules and when appraisals are required have not been updated for decades, and we are dealing with that. Why does a refinance of a property really need an appraisal? I mean, some of these things need to be addressed.

Mr. PURVIS. We historically have served primarily members in Wake, Durham, and Orange Counties, Raleigh, Durham, Chapel Hill, in central North Carolina, which are urban markets. Through a merger last year and some other decisions we made about where we wanted to do business, we are now focused on 16 counties in central North Carolina. Half of that is rural markets. We are kind of newbies beginning to look at what are the tools and programs available to help us do mortgage lending in those rural markets, and there are quite a number of those in that 16-county market.

Senator HEITKAMP. Comments?

Mr. HUNT. As a company who actually is the largest rural housing lender in the State—and we have been for 6 or 7 years—we certainly serve a number of rural markets throughout Georgia and into the surrounding States. It is extremely important that we keep community-based lending, whether that is a one-person office of an independent mortgage banker in that community to directly serve it or a community bank. Oftentimes in rural areas we see a lack of access to high-speed Internet, and with the current TRID regulations, that makes it more difficult on those borrowers when they do not have the proper Internet access to interact with their lender electronically. Keeping lenders in the communities so the borrower can easily drive to the actual location is very important, particularly for low- to moderate-income borrowers who do not have any extra money to spare.

Senator HEITKAMP. OK.

Mr. GIAMBRONE. Yeah, I would say, not to get too deep into the weeds, but Fannie and Freddie have come out with an appraisal standard, just to add to the panel, and it is called "Day 1 Certainty" at Fannie, where they give you a grade on your appraisal. I can tell you, in the rural areas it just does not work. It is a lot bigger process, and you really cannot rely on it. So if there is a way to change that model, for example, that——

Senator HEITKAMP. We are working on it.

Mr. GIAMBRONE. OK.

Senator HEITKAMP. If I could have just a minute to make a comment, I come from a town of 90 people. I know what relationship banking is. And I know what it means to be able to just walk down or drive 10 miles to your banker. We are losing that in rural America, and we need to figure out how actions here are driving that.

The other thing people ask me all the time, "How come I can get a loan for a $70,000 pick-up but not a $20,000 house?" It is an interesting—you explain that to people in my State with a lot of common sense, and you will be talking in circles by the time you are done. So we are with you. Thank you all for your input. Thank you for continuing to engage, hopefully, with this Committee, and we will hopefully get some results.

Chairman CRAPO. Thank you, Senator Heitkamp, and you make some very important points. I appreciate that.

Senator Brown has one more question to ask.

Senator BROWN. Yes, thank you for your indulgence, Mr. Chairman.

Senator Menendez asked you all a question that Mr. Giambrone gave a slightly different answer. He mentioned there should be no more than two guarantors in the market, and I would just like to hear thoughts from the rest of the panel—and I will start with you, Mr. Hunt—on what you regard is the right number and why. At what point do multiple entities break the TBA? If you would give us your thoughts, starting with you, Mr. Hunt, and moving to your right.

Mr. HUNT. Yes, Senator. So we support—and it is important that we do not have multiple GSEs that enter the market. It is already a complex market, and when we speak of the complexity of the market and you think of a small lender, the more complex it is, the more your legal costs rise. Your internal costs rise to try to keep up with all of the differences within the different GSEs. So as someone else on the panel alluded to earlier, consistency is extremely important, and the consistency that Fannie Mae and Freddie Mac provide to the industry today, the clear and concise underwriting guidelines that we see from Fannie and Freddie are important for smaller lenders to be able to operate.

So the more GSEs that we have, the less clarity we are going to have in the marketplace, and the more complexity we are going to add to the marketplace. And all of that complexity is going to continue to be a barrier to entry for small lenders, and it is also going to increase the cost to the consumer.

Senator BROWN. Thank you.

Mr. Purvis, briefly, if you can.

Mr. PURVIS. Yeah, we would expect the guarantors to be pretty tightly regulated, and unless there is a lot of flexibility within those regulations, why do you need two, three, four, five guarantors living with a fairly strict definition?

Senator BROWN. Mr. Hopkins.

Mr. HOPKINS. I would say that you had two that worked fairly well for 70 years until they started straying from their mission and the regulator allowed them to. We now have a strong regulator in place. Is it really necessary? They have $400 billion into their common securitization platform and another $600 billion to go. Do we need to duplicate that cost? I do not think it is necessary.

Senator BROWN. Tim.

Mr. MISLANSKY. I would agree with what others have said. I do not know that it is necessary to add and sometimes question whether it is necessary to have two. And do we need a signal—if there is a catastrophic Government guarantee behind these, why do you need necessarily two separate companies doing the same work essentially?

Senator BROWN. Ms. Hughes.

Ms. HUGHES. I would agree that we probably do not need more than two. I do like the idea of two because it does help with innovation of the products. We know that with the current regulatory environment we are in, mortgage lending is very complex, and having partners in the industry who help us determine the best path to get that done is vital. And having two systems helps create that innovation.

Senator BROWN. Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Cortez Masto.

Senator CORTEZ MASTO. Thank you. Thank you for your indulgence. And, excuse me, I have three Committee hearings going on at the same time, so I am trying to cover them and listen to some of the conversations that are taking place.

Ms. Hughes, I would like to start with you. In your testimony you recommended that banks should get a safe harbor from consumer litigation or CFPB enforcement as it relates to mortgage underwriting, so long as the bank holds the loan in portfolio. And my understanding is the thinking behind this is that a bank would never make a bad mortgage loan if they held it on their books.

However, the experience that I have seen, coming from Nevada, and particularly with Washington Mutual and Wachovia, suggests otherwise, at least for the largest banks. These failed banks were able to extract significant fee income up front, and then they would squeeze the borrower with fees if they fell behind on their payments. And then they could seize the home and resell it if the borrower went into foreclosure. We saw that in Nevada. I was the Attorney General there for 8 years, and we saw how devastating it could be.

So my question to you is: Would expanding the portfolio mortgage exemption to large Wall Street banks open the door to another Washington Mutual or Wachovia? Wouldn't you agree that the community financial institution relationship lending model is different than the model used by big banks?

Ms. HUGHES. Yes, I would agree with that. From our perspective, we—I personally struggle with qualified mortgage rules because if you are a partner in the industry and you want your consumers to be successful in home ownership, you have already underwritten them to a qualified standard. You have already worked with them. You know that they qualify. And as they go into—and the benefit of servicing locally is if they get into hard times, you know them at the consumer level, and you can work with them to work through the issues where they have some credit strain.

So I would agree that the community model definitely works better, and in our case, the regulatory requirements are actually restrictive and inhibit our abilities to serve our customers.

Senator CORTEZ MASTO. OK. And so to some extent, you would agree that narrowly targeting a portfolio mortgage exemption to an institution like yours makes sense; I mean, if we are really looking out for those protections.

Ms. HUGHES. Absolutely.

Senator CORTEZ MASTO. OK. Thank you. I appreciate that.

Let me move on to Mr. Giambrone. FHA loans are an important source of credit, particularly for first-time buyers seeking to enter home ownership. When the FHA Insurance Fund was not doing well in the aftermath of the Great Recession, the last administration made a series of changes to shore up its finances. One such change was requiring mortgage insurance to be paid over the life of the loan. Previously, borrowers could stop paying for this expensive insurance once they had 22 percent equity in their house.

Can you discuss the impact of this change in FHA policy? Has it impeded home ownership, particularly for first-time homebuyers? And should the FHA reconsider now that the Insurance Fund is in a much stronger position?

Mr. GIAMBRONE. Excellent question. Thanks for asking it. It should be reconsidered, yes. When it was done, I think it was done at a time when the fund was at a low point. That was in part because they put in the home equity portion. And at this point I think it actually hurts the fund because people would be more apt to refinance out of an FHA loan, which is actually taking funds away from the fund, because they have it for the life of their loan. So whether it would be back at 78 percent or 75 percent, it would be better to get rid of the life of the loan, and on the topic, we also think it is probably time to lower the monthly as well.

Senator CORTEZ MASTO. Thank you. And let me follow up also, which is an issue important for me, on affordable housing, affordable rental housing. In both northern and southern Nevada, we have an affordable housing crisis, and that includes rental. In fact, our State has the worst shortage of affordable and available rental homes in the Nation with only 15 units affordable for every 100 extremely low income households.

And so let me ask, Mr. Giambrone and Mr. Hunt, your organization signed on to a letter advocating for policymakers to consider the affordable rental housing crisis in the context of GSE reform. Can you discuss the necessity of not only preserving but expanding our commitment to the National Affordable Housing Trust Fund in the context of reform?

Mr. HUNT. Affordable housing, you know, is important across the Nation, so, you know, I believe that it is hard to determine exactly what the GSEs are going to do for affordable rental housing. You know, the multifamily side of things I am not really that familiar with, but that is very important, that we do provide avenues, you know, to stand up more affordable housing, and a lot of that actually speaks to some of the greater issues of the barrier entry to development at this point in time in the industry, takes much, much more capital. I am an independent mortgage banker, so I am not answering from the true banking side, but, you know, we all know it takes much more capital to enter those markets. And that is slowing the entry of continued development in the country.

Senator CORTEZ MASTO. I appreciate that.

Mr. Giambrone, do you have any comments?

Mr. GIAMBRONE. Yeah, just briefly, we have supported both funds. It is our understanding they have done great work in the past. Rental is a pathway to get to home ownership, and so we support that. I know the funds—and I am no expert at either, but whether it be the counseling or the downpayment assistance, again, or the rental, they have done good work, so we are supportive.

Senator CORTEZ MASTO. Thank you. I notice my time is up. Thank you all. I appreciate the comments.

Chairman CRAPO. Thank you very much. And I again want to thank all of the witnesses for being here today and providing your testimony, both your oral and your written testimony. It is very helpful as we move forward.

I do look forward to working with Senator Brown and the other Members of the Committee on this critically important issue.

For Senators who wish to submit questions for the record, those questions are due on Thursday, July 27th, and I encourage the witnesses, as you receive questions from the Senators, to please respond as promptly as you can.

With that, again, thank you very much, and this hearing is adjourned.

[Whereupon, at 11:31 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF BRENDA HUGHES

SENIOR VICE PRESIDENT AND DIRECTOR OF MORTGAGE AND RETAIL LENDING, FIRST FEDERAL SAVINGS BANK OF TWIN FALLS, IDAHO, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

JULY 20, 2017

Chairman Crapo, Ranking Member Brown, and Members of the Committee, my name is Brenda Hughes. I serve as Senior Vice President and Director of Mortgage and Retail Lending for First Federal Savings of Twin Falls, Idaho. I have been with First Federal for over 20 years. First Federal is a $607 million asset bank which was established in 1915. We currently have 11 branches and one production office and have 247 employees. We are the largest lender in our assigned lending area and have originated over $1 billion in mortgage loans in the last 10 years.

I am pleased to be testifying on behalf of the American Bankers Association on the important topic of GSE reform and community bank access. The ABA is the voice of the Nation's $17 trillion banking industry, which is composed of small, midsize, regional, and large banks that together employ more than 2 million people, safeguard $13 trillion in deposits and extend more than $9 trillion in loans.

In addition to my role at First Federal Bank, I served on Freddie Mac's Community Advisory Board from 2005 to 2016, serve on ABA's GSE Policy and Mortgage Markets Committees, chaired the ABA's Mortgage Markets committee from October of 2012 until September of 2014, and am the incoming vice chair of the ABA's GSE Policy Committee. I also currently serve on the CFPB's Community Bank Advisory Council.

First Federal actively delivers loans directly to Freddie Mac and to the Federal Home Loan Bank of Des Moines and we retain servicing on these loans. We also work with a handful of other market investors to whom we sell loans with servicing released. We currently service approximately 5,000 loans. Like so many banks, both large and small, access to the secondary market in general, and through the federally guaranteed secondary market enterprises (GSEs) in particular, is essential to our ability to meet the mortgage needs of our customers.

The American Bankers Association, through input and deliberation from banks of all sizes and from all parts of the country, has developed a set of principles to guide the reform of Fannie Mae and Freddie Mac, which, as you know, have been in conservatorship since 2008. We appreciate the work this Committee has done thus far, as well as the opportunity to share our views with you today.

On GSE reform, and on the importance of preserving access for lenders of all sizes and in all regions of the country, ABA believes that:

- Key shared principles should guide reform efforts;
- Without legislative reform, past abuses may be repeated, or new ones may arise which imperil the mortgage markets and put taxpayers at risk; and
- Reform need not be radical or extreme, but should be targeted and surgical.

I will elaborate on each of these in turn.

I. Key Shared Principles Should Guide Reform Efforts

ABA has (during the many years that Fannie Mae and Freddie Mac have been in conservatorship) worked with bankers from institutions of all sizes and from all parts of the country to develop principles which should guide reform of the GSEs. For the purposes of this testimony, we highlight the following principles, and note that many of these are widely shared among various other trade and industry associations.

We believe that these principles should form the basis for legislative reform efforts.

1. The GSEs must be strictly confined to a secondary market role of providing stability and liquidity to the primary mortgage market for low- and moderate-income borrowers and must be strongly regulated, thoroughly examined and subject to immediate corrective action for any violation.

A reformed system must ensure that the GSEs or their successors stay focused purely on advancing stable, affordable and readily available secondary market access to the primary market. Shareholder returns or other investment goals cannot be allowed to drive their behavior. While a certain level of competition is desirable to ensure innovation and responsiveness to the market, competition cannot be allowed to spin out of control and take the GSEs into other businesses or investment areas. For this reason some have suggested that a public utility or member-owned cooperative model may be a desirable evolution for the GSEs. We note only that while ownership structure is one way to limit and direct activities, strong regulation will also be necessary to keep GSEs or their successors focused on their defined role, regardless of what ownership structure is ultimately chosen.

2. In return for the GSE status and any benefits conveyed by that status, these entities must agree to support all segments of the primary market, as needed, in all economic environments and to provide equitable access to all primary market lenders.

The GSEs or their successors, including any potential new competitors that may be chartered, will benefit from a defined market available only to them and with a Government guarantee on the securities that are issued. To ensure that those benefits are available to all, GSEs must be required to provide access to all primary market lenders on an equitable basis.

3. Access must also include preservation of the "To Be Announced" (TBA) market and both servicing retained and sold options.

The To Be Announced market, also known as the Cash Window, allows originators to sell loans on an individual basis to the GSEs. This option must be preserved to ensure access to the secondary market for lower volume lenders or those who choose for business purposes to sell individual loans. Similarly, to ensure that originators may continue to service loans consistent with their chosen business model, flexibility to sell loans servicing retained or servicing released must be preserved in any reformed system.

4. Mortgage Backed Securities issued by the GSEs should carry an explicit, fully priced and fully transparent guarantee from the Federal Government.

The key benefit conveyed by the GSEs to the primary market is access to long-term affordable liquidity for mortgage lending. To preserve that liquidity, the Government guarantee is necessary, but taxpayers need to be fully compensated for the risks they bear in providing that guarantee. Fees necessary to support the guarantee must be charged, and must be transparent so that they reflect the true cost of the guarantee, and only that cost. Fees should not be assessed to offset other Government spending or priorities. It may be desirable to establish a segregated insurance fund to cover potential losses in the event that the guarantee is tapped in a crisis. Further, to ensure equitable access, the fees must be assessed equally on all lenders on a cost averaging basis.

5. The GSEs or their successors must be capitalized appropriately to the risks borne and regulated to ensure that they remain so in all market conditions.

Currently, Fannie Mae and Freddie Mac are operating under conservatorship, with little capital and with all profits being swept to the U.S. Treasury as compensation for the Federal investment and risks borne of behalf of taxpayers. It will be essential that going forward the GSEs or their successors have adequate capital to withstand market downturns, especially as they will be monoline businesses subject to regional and national downturns. Capital support for the guaranteed secondary market can come from a variety of sources, including indirectly from credit risk transfers, and injections of new capital from new member/owners/users of the GSEs or their successors (depending upon the model ultimately chosen by Congress).

6. Regulation of the GSEs must include establishment of sound and fair underwriting standards for the loans they purchase, and must be based upon and coordinated with underwriting standards applicable to the primary market.

Significant underwriting requirements imposed under the Dodd–Frank Act, most notably Ability to Repay (ATR) and Qualified Mortgage (QM) rules, while less than perfect, have significantly strengthened mortgage underwriting in the primary market. Going forward we believe it desirable that these primary market underwriting requirements serve as a basis that supports all secondary market activity, regardless of whether residential mortgages are sold to the GSEs or their successors or to private label purchasers. As a general matter, mortgages sold into the secondary market with Government guarantees should meet QM standards, whereas private label securitizations will only require the less stringent ATR standard as a baseline, although investors may establish additional standards at their discretion.

For the primary market, loans originated and held in portfolio should automatically be granted QM status so long as they meet basic Ability to Repay requirements and do not run afoul of safety and soundness regulations. Such loans are inherently conservatively underwritten as portfolio lenders hold 100 percent of credit risk and thus will only make loans that have a high degree of ability to be repaid.

For the secondary market, the so-called QM Patch currently in place effectively allows Fannie Mae and Freddie Mac to confer Qualified Mortgage status to any loan they are willing to purchase. As a result, Fannie Mae and Freddie Mac define the nature and extent of risks to which taxpayers are exposed. This was a necessary but flawed mechanism to ensure that the new rules did not overly restrict mortgage credit when regulations in 2014 subdivided ATR mortgages into QM and non-QM categories, and was deemed to be manageable as long as the GSEs were in conservatorship. However, the QM Patch is designated to expire when conservatorship of the GSEs ends, creating the necessity and opportunity to revise the QM/ATR rules so that the GSEs or their successors are not permitted to define what is QM without restriction. Whatever regulatory definition replaces the open-ended QM patch, GSE guarantees should be limited to loans that have well-defined and fixed criteria, and transition to a revised QM designation should be managed to avoid constricting credit availability. A properly QM requirement to "earn" a Federal guarantee is essential to protect taxpayers, and will help to guide non-QM mortgages to a private label secondary market without taxpayer exposure.

7. Credit Risk Transfers required by FHFA should be continued and expanded. Credit risk transfer must be a real transfer of risk and must be economically viable for the GSEs and the lenders they serve.

Several mechanisms for credit risk transfers have been critically important innovations introduced to the GSE model in recent years. They have helped to bring private market participation back to the mortgage markets, and have had a real impact on reducing taxpayer exposure to GSE risks. They should become a permanent feature of secondary market financing. However, they must continue to be developed in ways that make economic sense for the GSEs, investors, primary market lenders, and for the borrowers they serve. They must also truly transfer credit risk in a permanent fashion to ensure taxpayer protection. To that end, FHFA (or its successor) must vigorously regulate, examine, and enforce credit risk transfer requirements.

8. Any reform of the secondary mortgage market must consider the vital role played by the Federal Home Loan Banks and must in no way harm the traditional advance businesses of Federal Home Loan Banks or access to advances by their members.

The Federal Home Loan Banks (FHLBs) have provided mortgage financing in the form of collateralized advances to their member/owners for over 80 years. They have performed as intended, ensuring liquidity even in times of market crisis. Their crisis performance is traceable in part to mutual ownership status, relatively high statutory capital requirements and fully collateralized lending. Changes to Fannie and Freddie may affect the FHLBs, even if unintended or indirect, and potential effects must be considered, accounted for, and preferably avoided. Additionally, the FHLBs may have the potential to play an expanded role in a revised secondary market system, but any expanded role must be separately capitalized and regulated in such a manner that it does not put at risk the traditional advance business of the FHLBs.

9. Affordable housing goals or efforts undertaken by the GSEs to expand the supply of affordable rental housing should be delivered through and driven by the primary market, and should be structured in the form of affordable housing funds available to provide subsidies for affordable projects.

The bright line between the primary and secondary market in the single family housing finance area should also broadly apply to the affordable housing and multifamily market. Primary market lenders should be the originators of these loans supported by access to stable, long term liquidity from the GSEs. Only in complex originations where the primary market lacks capacity should the GSEs be involved in direct financing, and strong regulation and oversight should be employed to ensure that there is no "cherry picking" of deals by the GSEs from the primary market.

II. Without Legislative Reform, Past Abuses May Be Repeated

Prior to conservatorship, Fannie Mae and Freddie Mac existed as hybrid companies, in a duopolistic system. They had private shareholders who profited from risks taken with the implied guarantee of the Federal Government. Changes to the charters of the institutions must be undertaken in legislation to remove this private profit/public risk model. The GSEs should be transformed into cooperatively owned public utilities or other similar limited purpose, well-regulated entities.

Early in the conservatorship, Fannie Mae and Freddie Mac were unable to pay the 10 percent required interest rate on over $180 billion injected by U.S. taxpayers to prevent their collapse. As a result, the two were de facto nationalized with profits, if any, being swept to the U.S. Treasury. Under this arrangement, the interest payments on Government bailout funds has been waived. The GSEs operate with little and shrinking capital and are, under terms of the conservatorship, expected to go to zero capital by 2018.

Since returning to a positive cash flow in recent years, the terms of the conservatorship as amended have remained in place. Though funds swept to Treasury have been substantial, the amount falls substantially short of the taxpayers' direct investment plus the waived interest obligations on that investment. The terms of the conservatorship do not provide for a cutoff of payments (or for the debt incurred to be considered repaid) and do not allow for the GSEs to retain earnings to build capital.

Some have suggested that the GSEs simply be recapitalized and released back to the private market, with limited changes to their charters, noting that reforms to the entire mortgage market have addressed many of the problems that lead to the financial crisis and the insolvency of the GSEs.

We reject that approach, as it would return us to the untenable situation of public risk-taking to the benefit of private investors. Even with current reforms in place it would encourage future abuses and undue risks to U.S. taxpayers. Instead, legislation should establish directed and limited activities, strong capital standards and a clear set of benchmarks for implementing and meeting those standards.

It will also be essential for legislation to firmly establish a mandate that the GSEs provide equitable access to all primary market participants, regardless of size or geographic location. As cited in principle 2 above, in return for the GSE status, these entities must be willing to serve all primary market participants on an equitable basis in all market conditions. That includes access to the To Be Announced market (also known as the "Cash Window") with the ability to sell individual or groups of loans.

In recent years, and primarily as a result of a mandate by the FHFA, the GSEs have moved to standardized Guarantee fees (G-fees) for all primary market originators selling to the GSEs. Going back to the early 2000s, however, great pricing differentials existed, with the GSEs giving large volume discounts and other preferential pricing to some institutions. This un-level playing field severely hampered community banks' ability to compete and serve their communities.

Going even further back, some community banks found it difficult to do business with the GSEs at all, as their pricing and other policies were geared toward higher volume lenders and the GSEs showed little interest in working with smaller, lower volume banks.

It will be necessary to incorporate into statute the mandate that the GSEs serve all primary market participants equitably in order to avoid the potential for backsliding.

Some will argue that this can be accomplished via regulation, and indeed, FHFA has done an admirable job in recent years ensuring equitable treatment. However, regulators and regulatory approaches can change over time. While a strong regulator must be part of reform, so too must be clear statutory guidance in this area.

III. Reform Need Not Be Radical or Extreme, But Targeted and Surgical

Legislation considered by the Senate Banking Committee in the last Congress envisioned a complete restructuring of the secondary mortgage market system. That legislative approach was ultimately not able to gain approval at least in part over concerns that it was too complex and untested, and that the transition from the current system to a new one envisioned in the legislation would be too disruptive to the housing finance system.

Still, the legislative efforts undertaken by the Senate were helpful in focusing attention on the key services provided by the GSEs in the past, and in delineating how some of those services could be separated into component parts, and reassigned in a new system to reduce risk and create opportunity for greater competition.

Consensus is forming around the view that a limited and controlled Government involvement in the secondary mortgage market is needed to ensure the availability of stable, affordable long term financing for mortgage finance.

Legislation need not recreate the entire secondary market structure. In fact, guided by the principles detailed above, and incorporating key elements laid out here, we believe that relatively tailored legislation that takes a surgical approach to making necessary alterations to the current system is both desirable and achievable.

In addition to changes to the charters and ownership structure of the GSEs, the creation of clear, achievable and strict capital requirements, and the mandate to serve all primary market participants equitably, these surgical alterations should also include creation of an insurance fund to backstop the GSEs capital to protect taxpayers further from again having to bailout the GSEs. While the Government should stand behind the securities issued by the GSEs, the insurance fund should stand in front of the explicit Government guarantee to repay taxpayers to reduce the likelihood that the Government guarantee is ever drawn upon. The fund should be actuarially sound and modeled on the FDIC insurance fund.

Conclusion

Americans have relied on long-term, fixed-rate mortgages for affordable mortgage finance for 70 years. Fannie Mae and Freddie Mac have facilitated access to this product by providing access to the capital markets for primary market lenders. Absent aggregation and securitization provided through the To Be Announced (TBA) market, access to long-term, lower-rate funding would be far more difficult to come by for most primary lenders. The Government guarantee provided to mortgage backed securities issued by the GSEs makes them attractive to the capital markets ensuring liquidity. All of these elements must be preserved and remain available to all primary market participants regardless of size or geographic location.

Congress has an essential role in providing the certainty necessary to ensure long-term stability of the housing finance system. Just as the Federal debt market provides the bellwether that makes all private debt markets more efficient and liquid, an explicit, fully priced, fully paid-for Federal guarantee for a targeted portion of the mortgage market will be a catalyst for broader market growth and development. Congress should not defer action any longer. Nine years of conservatorship is more than enough.

Thank you for the opportunity to share our views with the Committee. The American Bankers Association stands ready to work with Members of the Committee to advance this important set of issues.

PREPARED STATEMENT OF TIM MISLANSKY

SENIOR VICE PRESIDENT AND CHIEF LENDING OFFICER, WRIGHT–PATT CREDIT UNION, AND PRESIDENT, MYCUMORTGAGE, LLC, ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION

JULY 20, 2017

Chairman Crapo, Ranking Member Brown, Members of the Committee: Thank you for the opportunity to testify on this important topic. My name is Tim Mislansky, and I am the Chief Lending Officer for Wright–Patt Credit Union, headquartered in Beavercreek, Ohio, as well as the President of its wholly-owned Credit Union Service Organization (CUSO), myCUmortgage. I am also Chair of the Housing Subcommittee of the Credit Union National Association (CUNA),[1] on whose behalf I testify today.

Wright–Patt Credit Union has approximately $3.6 billion in assets, and proudly serves over 337,000 members. We are located primarily in the Dayton and Columbus, Ohio markets. This gives us a unique perspective on the marketplace as we make home loans available in the urban core, the suburbs and the rural areas of our markets. We are a relatively large credit union mortgage lender, and helped 4,631 families in 2015 with $616 million in balances, of which 3,072 were originated to Wright–Patt Credit Union members, and an additional 1,340 families with second mortgages, totaling $55 million.

In addition to my role at Wright–Patt, I serve as president of our wholly-owned CUSO myCUmortgage, which provides a variety of mortgage related services to nearly 200 credit unions. These credit unions range in asset size from $6 million to $1 billion and are located in 25 different States. Through the CUSO, we facilitated nearly 9,000 closings for $1.2 billion making myCUmortgage one of the largest aggregators of credit union mortgage loans in the country. These responsibilities give me a unique perspective of the mortgage lending needs of small lenders and their members.

As member-owned, not for profit financial cooperatives, many credit unions offer mortgages to satisfy member demand, and credit unions represent an increasingly significant source of mortgage credit nationally. In 2016, more than two-thirds of credit unions were active in the first mortgage arena, collectively originating over $143 billion worth of these loans—an amount equal to 7.5 percent of the total market. By comparison, in 1996 only 43 percent of credit unions were active and originated a total of less than $20 billion in first mortgages.

And third party data supports credit unions' growing presence as a mortgage lender. Most recently, Experian, one of the major credit reporting bureaus, indicated

[1] Credit Union National Association represents America's credit unions and their 110 million members.

in a report that in the first quarter of 2017, credit unions accounted for 13 percent of the first mortgages originated, representing an increase for its 7 percent market share in the first quarter of 2015.[2]

It is clear that consumers are choosing credit unions more and more to be their mortgage lenders, and as Congress considers housing finance reform, it is critical that credit unions have equitable and readily available access to a functioning, well-regulated secondary market and a system that will accommodate member demand for long-term fixed-rate mortgage products in order to ensure they can continue meeting their members' mortgage needs.

Historically, credit unions have been largely portfolio lenders. From 2000 to 2008, credit unions sold only a third of first mortgage originations, ranging from a low of 26 percent in 2007 to a high of 43 percent in 2003. The decision of whether to hold or sell a loan depends primarily on asset-liability-management issues, essentially the need to manage interest rate risk, but also at times, depends on the availability of liquidity in the credit union. Asset liability management hinges on such factors as the level of interest rates, the relative demand for fixed versus adjustable loans from members, the amount of fixed-rate loans and other longer-term assets already on a credit union's books and the maturity of the credit unions funding sources. Managing credit risk is a primary concern of the credit union prudential regulator. Without a functioning secondary market, credit unions would most likely severely limit the amount of first mortgage lending conducted on behalf of their members as they simply would not have the liquidity to fund and hold the loans.

As long-term interest rates plunged in 2009 and again in 2011, credit unions found it increasingly important to sell longer-term, fixed-rate mortgages to avoid locking in very low earning assets for the long term. As a result, whereas in 1996 only about 16 percent of mortgage lending credit unions sold loans into the secondary market, by 2016, nearly 30 percent of mortgage lending credit unions sold $56 billion into the secondary market, or 40 percent of total first mortgages originated by credit unions.

Servicing member loans is very important to credit unions, for a number of reasons. As member-owned cooperatives, credit unions are driven by a desire to provide high quality member service. Many credit unions are reluctant to sell the core function of serving members to others. Credit unions may service loans in-house or outsource to a trusted third-party, but in doing so they maintain a say in how the loans are serviced. This is especially important when borrowers run into financial challenges so that the credit union may work to keep the borrower in their home. Credit unions are also concerned that if they sell the servicing of the mortgage loan, that the third-party servicers will use the data they gather about credit union members to market competing products or services. In addition, credit unions benefit from the steady servicing income stream. As such, many credit unions service both the substantial portfolios of loans they hold on their own balance sheets, and the loans they have sold to the secondary market. Currently, in addition to the $366 billion of first mortgages that credit unions hold in portfolio, they also service $198 billion of loans they have sold.

The credit quality of credit union first mortgages held up remarkably well during the recent financial crisis, especially when compared to the experience of other lenders. Other lenders experienced net charge-off rates four times higher than those at credit unions. Prior to the Great Recession, annual net charge-off rates on residential mortgage loans at both banks and credit unions were negligible, less than 0.1 percent. However, as the recession took hold, losses mounted. At credit unions, the highest annual loss rate on residential mortgages was 0.4 percent. At commercial banks, the similarly calculated loss rate exceeded 1 percent of loans for 3 years, reaching as high as 1.58 percent in 2009.

There are two reasons for this remarkable record at credit unions. First, as cooperatives, credit unions are generally locally owned, community based institutions and tend to be more borrower-centric than other lenders. This equates to credit unions generally being more risk-averse than stock-owned or privately owned institutions. The environment faced by credit union management (generally uncompensated volunteer boards, the absence of stock options for senior management and board members, the absence of pressure from stockholders to maximize profits) discourage management from adopting high-risk, higher-return strategies in pursuit of high profits. As a result, credit union operations are more consumer-friendly, less risky and subject to less volatility over the business cycle. This largely explains why credit unions were able to increase lending as the financial crisis deepened.

Second, credit unions are member-owned cooperatives and the financial transactions involving a member's home are typically the biggest of their lives, credit

[2] *http://www.experian.com/assets/credit-unions/reports/cu-state-of-credit-report.pdf*

unions tend to be concerned with not only the member's ability to obtain the home loan, but also to maintain the home loan. This leads credit unions to pay particular attention to such factors as a member's ability to repay a loan, proper documentation and due diligence, and collateral value before granting loans.

Credit Union Principles for Housing Finance Reform

As we have testified in the past, CUNA supports the creation of an efficient, effective, and fair secondary market with equal access for lenders of all sizes. To this end, CUNA supports housing finance reform proposals that are consistent with the following principles, and have been subject to full and fair consideration with respect to potential impact as well as unintended consequences on all market participants:

Neutral Third Party

There must be a neutral third party or parties in the secondary market, with the sole role as a conduit to the secondary market. This entity must be independent of any firm that has any other role or business relationship in the mortgage origination and securitization process, to ensure that no market participant or class of participants enjoys an unfair advantage in the system. In addition, this party must be prohibited from holding mortgage loans as individual loans or mortgage backed securities to avoid additional interest rate risk being held and managed by the entity. Some proposals have suggested that the new solution would allow financial companies to own up to 10 percent of an entity. This idea is troublesome as it could create potential conflicts of interest and increases the likelihood that larger lenders could band together to create and own a secondary market entity, thereby controlling the market and forcing their financial will on smaller lenders.

Equal Access

The secondary market must be open to lenders of all sizes on an equitable basis. Access should not only be provided to individual lenders, but to companies that act as loan aggregators. Despite today's relatively equal access to the GSEs, some lenders choose to work with an aggregator, such as a company like myCUmortgage, which buys loans to pool and sell to the GSEs. These institutions find it a better financial and operational alternative to partner with an aggregator than to sell directly to the GSEs. The secondary market must remain open to both direct lenders and aggregators to allow small lenders to continue making mortgage loans in the manner they choose to help consumers with home ownership.

CUNA understands that the users (lenders, borrowers, etc.) of a secondary market will be required to pay for the use of such market through fees, appropriate risk premiums and other means. However, guarantee fees or other fees/premiums should not have any relationship to lender volume. The fees must be tied to the risk of the individual loan or pools of loans.

Additionally, CUNA cautions strongly against regimes that require lenders to retain significant amounts of risk beyond that represented by actuarially appropriate guarantee fees, as these risk retention arrangements may have a disproportionately negative impact on small lenders that are less able to manage such risk or who have the balance sheet capacity to hold such risk, and could therefore result in less consumer choice.

One such example is a client of myCUmortgage, TopMark Federal Credit Union in Lima, Ohio is on pace to help their members with over $16 million in mortgage loans this year. TopMark is a $30 million depository, yet manages to generate nearly half its assets per year in mortgage loans. Without a functioning secondary market, or if onerous risk retention arrangements were imposed, TopMark may have to stop helping its members with home financing in just a few short years.

Strong Oversight and Supervision

The entities providing secondary market services must be subject to appropriate regulatory and supervisory oversight to ensure safety and soundness by ensuring accountability, effective corporate governance and preventing future fraud; they should also be subjected to strong capital requirements and have flexibility to operate transparently and develop new programs in response to marketplace demands.

Durability

Any new system must ensure mortgage loans will continue to be made to qualified borrowers even in troubled economic times. Without the backstop of an explicit federally insured or guaranteed component of any revised system, CUNA is concerned that private capital could quickly dry up during difficult economic times, as it did during the financial crisis, effectively halting mortgage lending altogether. In addition, the introduction of private capital, in a highly regulated industry, such as mortgage lending, will be discouraged without the explicit Federal guarantee. The costs and barriers to entry for other entities will most likely be high and the potential returns may not justify entry with the guarantee. This could lead to higher risk lending in order to gain short-term larger profits at great potential long-term risk as we saw during the financial crisis with exotic mortgage products and tremendously relaxed underwriting standards.

Financial Education

Credit unions have a noble history of offering a wide variety of financial counseling and other educational services to their members, and numerous studies, including an analysis from HUD in 2016,[3] have shown that first time home buyers who complete pre-ownership home buying courses perform statistically better in terms of default risk and repayment than those who do not. In one case, a study cited by HUD indicated that those who took pre-purchase education had a ⅓ less chance of ending up in default. Any new housing finance system should emphasize consumer education and counseling as a means to ensure that borrowers receive appropriate mortgage loans.

Predictable and Affordable Payments

Any new system must include consumer access to a variety of products that provide for predictable, affordable mortgage payments to qualified borrowers. Traditionally this has been through fixed-rate mortgages (such as the 30-year fixed-rate mortgage), but other products that may be more appropriately tailored to a borrower's specific circumstances, such as certain borrower-friendly, standardized adjustable rate mortgages, should also be available.

We believe that in addition to ensuring access to the secondary market for credit unions, it is also important that the housing finance system Congress puts in place accommodates the demand of credit union members and other consumers for long term, fixed-rate mortgage products. The data suggest that credit union members overwhelmingly prefer fixed-rate mortgages. Over the past 10 years, our members have chosen a fixed-rate mortgage about 80 percent of the time. Congress should acknowledge that the American homebuyer prefers fixed-rate mortgages and do everything in its power to ensure this important mortgage product remains a valuable part of housing finance.

Loan Limits

Our Nation's housing market is diverse, with wide variation geographically and between rural and urban communities. Any new housing finance system should apply reasonable conforming loan limits that adequately take into consideration local real estate prices in higher cost areas. It should also ensure that lower balance mortgage lending is not discouraged. Many lenders have established minimum loan amounts as the profitability of a mortgage loan is impacted by loan size. These smaller loan amounts can be typical in urban areas where the cost of a home is significantly less. For example, in Dayton, Ohio, a member can buy a home for less than $50,000 but often cannot find a lender available to them. Wright–Patt Credit Union does not have minimum loan amounts as we believe, as a financial cooperative, that we should help every qualified member buy a home regardless of the size of the home or the mortgage loan.

Affordable Housing

The important role of Government support for affordable housing (defined as housing for lower income borrowers but not necessarily high risk borrowers) should be considered a function separate from the responsibilities of the secondary market entities. The requirements for a program to stimulate the supply of credit to lower income borrowers are not the same as those for the more general mortgage market. We believe that a connection between these two goals could be accomplished by either appropriately pricing guarantee fees to minimize the chance of taxpayer expense, and/or adding a small supplement to guarantee fees, the proceeds of which could be used by some other Federal agency in a more targeted fashion in furtherance of affordable housing goals.

Credit unions historically have played an important part in low and moderate income mortgage lending. An analysis of publicly available HMDA data from 2013 to 2015 shows that 25 percent of credit union lending is considered "CRA" lending. This compares to 23 percent for non-credit union institutions. While the difference is a relatively minor 2 percent, it must be remembered that credit unions are not

[3] The Evidence of Homeownership Education and Counseling *https://www.huduser.gov/portal/periodicals/em/spring16/highlight2.html.*

subject to the Community Reinvestment Act, yet a larger percentage of our loans are CRA equivalent compared to those lenders that are primarily subject to CRA.

Mortgage Servicing

In order to ensure a completely integrated mortgage experience for member-borrowers, credit unions should continue to be afforded the opportunity to retain or sell the right to service their members' mortgages, at the sole discretion of the credit union, regardless of whether that member's loan is held in portfolio or sold into the secondary market. Consumers align the mortgage loan with where they make their payment and this impacts their choices in selecting a mortgage lender. To lose control over this servicing relationship would be detrimental not only to a large majority of credit union member-borrowers, but could also result in fewer mortgage choices available to credit unions and their members, with higher interest rates and fees alike. Moreover, to the extent national mortgage servicing standards are developed, such servicing standards should be applied uniformly and not result in the imposition of any additional or new regulatory burdens upon credit unions.

Reasonable and Orderly Transition

Whatever the outcome of the debate over the housing finance system in this country, the transition from the current system to any potential new housing finance system must be reasonable and orderly, in order to prevent significant disruption to the housing market which would harm homeowners, potential homebuyers, the credit unions who serve them, and the Nation's housing market as a whole.

Small Lender Access to the Secondary Market

The secondary market must be open to lenders of all sizes on an equitable basis. Credit unions need to know that as long as they produce even a single eligible mortgage, they will be able to sell it to an issuer of Government-backed securities, directly or through an aggregator, at market prices, for cash, without low-volume penalty, or through the TBA market, and with the option to retain servicing on the loans. In addition, standardization of all steps of the process is very important to credit unions.

Some form of issuer should be established so that small lenders, including credit unions, will have unfettered access to the secondary market. This entity should be independent of any firm that has any other role or business relationship in the mortgage lending process.

Government Guarantee

The new system must include consumer access to products that provide for predictable, affordable mortgage payments to qualified borrowers. Traditionally this has been provided through fixed-rate mortgages (such as the 30-year fixed-rate mortgage), and it is important that qualified borrowers continue to have access to products that provide for predictable and affordable mortgage payments.

In order to facilitate the continued availability of affordable, long-term, fixed-rate mortgages for American homeowners, some form of ultimate Government guarantee should be available for qualifying mortgage-backed securities. However, the taxpayer must be protected from the unnecessary exercise of this guarantee by appropriate standards in mortgage lending, and by layers of sufficient private capital for loss absorption. The Government guarantee should be the last, not the first line of defense.

In addition to an 80 percent maximum loan-to-value for each mortgage in a covered security (provided by downpayment, private mortgage insurance or a combination of the two), sufficient private capital should be available to absorb the first loss on any mortgage in a covered security. The amount of private capital necessary to protect the taxpayer is of course important. Too little capital places the taxpayer at risk. Too great a capital requirement unnecessarily raises the cost of mortgages to borrowers. The appropriate amount depends on: the amount of capital held by the ultimate Government guarantor, the amount of loss on any security that the private capital will be responsible for (the attachment point), and the maximum loan-to-value of mortgages in covered securities and required underwriting standards for eligible mortgages. Assuming an attachment point of 10 percent, the amount of private capital necessary to cover a maximum 10 percent loss on any covered security will be substantially less than the amount necessary to cover a maximum 10 percent on all covered securities. So long as eligible mortgages must have maximum loan-to-value ratios of 80 percent, or private loan-level mortgage insurance and must comply with the Qualified Mortgage (QM) rule, the likelihood that all covered mortgage backed securities would simultaneously suffer losses of at least 10 percent during anything short of a total economic and financial collapse (such as the Great Depression of the 1930s) is negligible. Further, the required amount of capital or reserve funds should depend on the seasoning of the securities on which a bond guarantor provides first loss coverage. Older securities should require lower (not zero) reserve funds.

For all the reasons just listed, substantially less than 10 percent of the total exposure of private bond guarantors would be necessary to provide the 10 percent first loss coverage. Legislation should require the 10 percent first loss coverage, but leave it to the Federal guarantor to determine the amount of private capital or reserve funds necessary to provide that 10 percent first loss coverage under conditions no less severe than the recent Great Recession.

In the event of the failure of a mortgage in a covered security, the Federal guarantor should ensure timely payment of principle and interest to investors in covered securities, and immediately demand payment from the bond guarantor. The fact that investors could look to the Federal guarantor rather than a collection of private bond guarantors for payment would contribute to the homogeneity of covered securities, increasing the liquidity of the securities. Payment from the private guarantor to the Federal guarantor would be required so long as total losses on a security (or a defined group of securities, such as a vintage) had reached 10 percent of the value of the security. In the event total losses on mortgages in a security or group exceed 10 percent of the value of the security or group, the Government backup fund should cover losses in excess of 10 percent.

It is likely that under this arrangement there could actually be instances when the Government backup fund covered losses on covered securities without the bond guarantor itself having to fail, i.e., if one or more but not all of the securities covered by a private bond guarantor experienced losses of greater than 10 percent, but the private guarantor's capital was not depleted. Indeed, a properly reserved guarantee fund should be able to cover losses up to 10 percent of the balance of covered securities and still remain in business. In other words, the payment of losses by Federal guarantor after the 10 percent first loss coverage should not require a catastrophic event, i.e., the exhaustion of a pool of private capital.

A 10 percent attachment point would likely make recourse to the Government backup fund extremely rare, but not unheard of. A reformed housing finance system that envisages no payments out of the privately funded reserve balance of the Government guarantor would be erring on the side of being too conservative. The goal should be absolute protection of taxpayers, and that should allow the Federal guarantor to occasionally operate as a shock absorber, using funds it has collected from market participants. This would be similar to the way the National Credit Union Share Insurance Fund (NCUSIF) and the Federal Deposit Insurance Company (FDIC) pay depositors in failed federally insured credit unions and banks, not with taxpayer funds, but with reserves paid for by insured institutions.

The Government should be prohibited from assisting private guarantors. In other words, the Government should insure the mortgage bonds but not the mortgage bond issuer. Instead, the Government should be prepared to quickly pay all legitimate claims not covered by a private guarantor, and to resolve the private guarantor if the Government is not reimbursed for such claims in a timely fashion. The Government should also be prepared to temporarily sell first loss coverage to issuers in times of market stress.

The entity that provides the Government guarantee should also have regulatory responsibility. Since the entity that provides the Government guarantee will be responsible for protecting the taxpayer from losses resulting from that guarantee, that entity must have the authority to establish regulations to ensure that all of the many players in the complex housing finance system act in a fashion that does not expose the taxpayer to any losses.

Underwriting and Other Mortgage Standards

Ultimately, the underwriting standards for a loan to qualify for inclusion in a covered security should be controlled by the Government entity responsible for covering losses on such securities. A similar system has worked fairly well for the FDIC and NCUSIF in establishing prudential standards for bank and credit union operation. Therefore, the less explicitly underwriting standards are prescribed in legislation, the better. Whereas QM standards could serve as a starting point for standards established by the Federal issuer, the law should not explicitly require that only QM loans could be eligible mortgages. The ability of a borrower to repay a loan depends on a number of characteristics; not just the absolute level of each characteristic, but also the interplay among those characteristics. Many of the underwriting standards of the QM rule are appropriate for an eligible mortgage: documentation requirements, payment and debt ratio calculation methods, prohibition of harmful loan features such as negative amortization, etc. But a bright line ceiling of 43 percent on the debt-to-income ratio, without any ability to consider other factors, would exclude too many qualified borrowers from enjoying the benefits of covered mortgages. For example, consider a borrower applying for an adjustable rate mortgage with annual adjustments after 1 year, a low downpayment and a barely prime credit score. For such a borrower, even a 43 percent debt ratio could be far too high. However, for another borrower applying for a 30-year, fixed-rate loan with a large downpayment, an active and pristine credit record and other positive characteristics, a 50 percent debt ratio could be completely acceptable.

The Federal issuer should be instructed by Congress to create standards that facilitate consumer access to mortgage credit consistent with the overriding goal of minimizing risk to the taxpayer of paying for losses on covered securities, recognizing that those standards should evolve through time. Those standards may be similar to QM standards, but should not be required to be the same as QM standards.

This system currently exists with Fannie Mae and Freddie Mac. Their underwriting standards are the standards of the mortgage industry. A new or revised system should build upon these standards rather than start from scratch. In addition, the current GSE system has developed standardization across the mortgage industry in the Uniform Residential Loan Application, loan documents, appraisal standards, income calculation and many other areas. These standardizations have benefited consumers and lenders by creating consistency and efficiency in the marketplace and contribute to a well-functioning secondary market. As a new secondary market is envisioned, these standardizations must be considered so that standardization in mortgage lending remains. The unintended consequences of a failure to continue the standardization would be higher costs to borrowers and a sort of Wild West of mortgage lending in relation to a secondary market.

Regulatory Structure

The entities providing secondary market services must be subject to appropriate regulatory and supervisory oversight to ensure safety and soundness, for example by ensuring accountability, effective corporate governance and preventing future fraud; they should also be subjected to strong capital requirements and have flexibility to operate well and develop new programs in response to marketplace demands.

The regulator created through any reform of the housing finance system must have a role centered on supporting securitization that does not duplicate the role of other regulators in the process. Both issuers and servicers are heavily regulated by a myriad of Federal agencies, including the Bureau of Consumer Financial Protection (CFPB), Department of Housing and Urban Development, Department of Veteran Affairs and Department of Agriculture, in addition to the supervision performed by prudential regulators. Credit unions and other small lenders are drowning in regulation in the mortgage area, and we fear curtailing products and services as a result. Credit union members, and our housing recovery, lose as a result of regulatory burden. It is essential that any housing finance reform not create additional regulatory burden at the originator or servicer level; in fact, if done properly, the implementation of a new housing finance system could provide an opportunity to reduce credit unions' and other small lenders' regulatory burden, as we discuss later in this testimony.

That said, the secondary market needs strong regulatory oversight to ensure equal access for small institutions and an orderly functioning of the system. At a high level, the regulator should be a neutral third party that would ensure the secondary market is open to lenders of all sizes on an equitable basis, with equal pricing regardless of lender volume. Ideally, the regulator would provide issuers who feel they are not receiving equal treatment in the secondary market with an administrative process to protest. In turn, the regulator should have substantial authority to order a remedy, including banning a violating secondary market participant from accessing the Federal issuer.

We envision a regulator in the mold of the National Credit Union Administration (NCUA) or the Federal Deposit Insurance Corporation (FDIC), with direct examination and supervisory authority, given that the full faith and credit of the United States stands behind the Federal backstop, as it does with NCUA or FDIC insurance. The entities providing secondary market services must be subject to appropriate supervisory oversight to ensure safety and soundness, for example by ensuring accountability, effective corporate governance and preventing future fraud; they should also be subjected to strong capital requirements and have flexibility to operate well and develop new programs in response to marketplace demands. In terms of specific powers, at a minimum, the regulator should have the authority to make rules, examine and supervise secondary market participants, suspend or revoke the power of any secondary market participant to enjoy a Federal backstop, place any secondary market participant into conservatorship or involuntary liquidation and study the operation of the secondary mortgage market to determine if its regulations are leading to the most efficient operation.

In terms of the regulator's governance structure, we recommend a board appointed by the President with the advice and consent of the Senate that would serve for fixed terms of 5 or more years (so as to be longer than the term of any one President). It is important for credit unions that, by statute, the board be required to include credit union representation. The board members should have minimum qualifications set by statute and come from the private marketplace, not be representatives of another regulatory agency. We leave it to Congress to set the minimum criteria for service on the board, but note that a minimum of 10 years of mortgage lending experience should provide the operational knowledge necessary to understand issuer concerns. Staggering terms of service makes sense to ensure continuity of the board.

The regulator could be funded by a small portion of the guarantee fee. We believe the regulator should have an Office of Small Lender Access and Equality, dedicated to the concerns of credit unions and banks under a certain threshold in assets. That office should have the authority to study the pricing small institutions receive in the secondary market to determine if small institutions receive fair pricing.

In terms of the regulatory issues surrounding "too big to fail" and the housing regulator's interaction with other regulators, the new housing regulator should have a seat on Financial Stability Oversight Council (FSOC) and generally should be given similar authority as the FDIC and Federal Reserve over systemically important entities under the Dodd–Frank Act. The regulator should be required to consult with FSOC before placing a systemically important secondary market participant into conservatorship. To the extent not already the case under current law, any nonbank that is a participant in the secondary market should be subject to a possible systemically important designation, and should have to draft a "living will" if so designated. The new regulator should have a direct role in reviewing the living wills of any secondary market entity, as is the case with the FDIC and Federal Reserve. Where State-chartered entities, including insurance companies, are concerned, the company would be resolved under State law, but the Federal housing regulator would have the authority to step in to handle that resolution if the appropriate State authority did not take what the regulator deemed to be the necessary action, as is true of the FDIC's similar authority under the Dodd–Frank Act.

Servicing Standards

Credit unions should continue to be afforded the opportunity to provide mortgage servicing to their members in a cost-effective and member-service oriented manner, in order to ensure a completely integrated mortgage experience for credit union members. To lose this servicing relationship would be detrimental not only to a vast majority of credit union members, but could also result in fewer mortgage choices available to credit unions and their members, with higher interest rates and fees being imposed on both.

Initial national mortgage servicing standards will likely be part of the common securitization platform being developed under the auspices of FHFA. They should be applied uniformly and not result in the imposition of any additional or new regulatory burdens upon credit unions. Going forward, private market participants should be able to revise servicing standards subject to oversight by the successor issuer(s), which should also have legal authority to ensure that the development and implementation of all servicing standards are reasonable and fairly applied for all servicers; legislation should ensure that eligibility requirements, compensation to or fees collected from servicers are not strictly based on volume but also reflect other reasonable factors such as in the case of compensation, the performance of the loans serviced.

To ensure that all servicers are treated fairly and appropriately by the mutual securitization company, the legislation should establish an ombudsman to interact with servicers and create a review process under which complaints raised by servicers will be investigated and resolved in a timely manner.

The regulation of servicing should be bifurcated with the successor Federal issuer(s) overseeing how standards for servicing necessary to support securitization are developed while the protection of consumers in the servicing process should be left to the CFPB. In other words, no entity should be granted authority to impose any additional consumer protection servicing requirements on regulated financial institutions that service mortgage loans. Such protections have already been established under a statutory and regulatory framework under the purview of the CFPB. While improvements to the current framework, such as changes to the servicers' exemption levels to ensure regulatory burdens on smaller servicers are minimized, should be considered, the regulation and oversight of the servicing process, including standards, should be left to the CFPB.

Transition Issues

The transition from the current system to any new housing finance system must be reasonable and orderly. The transition should end when the new system is fully functional, rather than after any specified period. Further, we recommend that the common securitization platform now being developed under the direction of the FHFA should be available to all market participants. Finally, once the earnings of the GSEs have fully paid back all Government costs of their conservatorship, any further GSE earnings during the transition should be available to cover costs of standing up the new system, and beginning the funding of the reserve balance of the successor issuer(s).

The Federal Credit Union Act limits the types of investments that credit unions can hold. Since Government agency securities are one of the few investments allowed, they tend to purchase and hold many of these securities. Therefore, in order to ensure the safety and soundness of credit unions, and to ensure the new securities perform on par as the current GSE securities we suggest a phased in approach to issuing the new security that would be blended with the Fannie and Freddie issued securities to ensure the investments hold their value and market stability is maintained.

To minimize market disruption, we would suggest that Fannie Mae, Freddie Mac, and the new issuer be allowed to operate simultaneously so that all parties can get acquainted with the new system. In addition to gaining familiarity with the new system, it would be appropriate for both the GSE's and the new issuer to start issuing securities with each trying to mirror or have very similar characteristics of the other. As the last step in the process before Fannie Mae and Freddie Mac are wound down, blending the two securities together and selling them for a period of time under the new issuer name may provide the market the necessary time to become comfortable with the new security. Ideally, market participants will not notice any sudden changes on the day that the GSEs are shuttered and the new system takes over. The many changes necessary to move from the old to the new system would already have happened gradually during the transition.

Finally, the common securitization platform now being developed under the direction of the FHFA should be available to all market participants. It could be "owned" and controlled by the new issuer, or a separate entity made up of all issuers of covered securities. Its use should be required for all covered securities, which would likely make it the default for private label securities. Regardless of who owns it, if its use were required for all covered securities, the new issuer would have de facto regulatory control over it.

Additional Concerns Specific to Credit Unions

Statutory limitations restrict the ability of credit unions to more fully serve their members and may inhibit their ability to be complete participants in the reformed housing finance system. Therefore, we would strongly encourage the Committee to consider the following statutory changes specific to credit unions as part of the reform of the housing finance system.

Investment Authority

Section 107(7) of the Federal Credit Union Act (12 U.S.C. 1757(7)) limits the types of investment that Federal Credit Unions may make to loans, Government securities, deposits in other financial institutions, and certain other limited investments. We believe that depending on the nature of the entity created as a successor to the GSEs, credit unions may need additional investment authority in order to capitalize that entity, and we encourage the Committee to provide that authority.

Multifamily Housing

Credit unions are not significant participants in the multifamily mortgage market primarily because of the statutory cap on business lending imposed in 1998. This cap limits credit unions business loan portfolio to essentially 12.25 percent of the credit unions assets. Compounding the matter, the Federal Credit Union Act considers a loan made on a 1-4 family non-owner occupied residence a business loan; whereas the same loan made by a bank would be considered a residential loan. Comprehensive housing finance reform legislation may provide the opportunity to correct this disparity in the statute. We encourage the Committee to include language that would amend the Federal Credit Union Act and consider loans made on 1-4 family residential properties as residential loans.

Relief From Dodd–Frank Act Mortgage Regulations

As Congress considers comprehensive housing finance reform legislation, it also may be prudent to consider changes to Dodd–Frank Act related mortgage regulations. The CFPB has finalized many thousands of pages of regulations with which credit unions and other community-based financial institutions must comply, despite the fact that they did not cause the mortgage crisis and have, throughout history, employed the strong underwriting principles the rules are designed to require.

The compliance obligations imposed by these rules—some of which were finalized in September and are effective in January—are simply overwhelming to many credit unions, and the tight timeframe for compliance puts the availability of mortgage credit at risk. While there has been suggestion by the CFPB and other regulators that they may not cite financial institutions for noncompliance for a period of time after the compliance date, the law carries a private right of action which would make credit unions and others vulnerable to lawsuits for noncompliance even as they work in good faith toward compliance. Another year would ensure that mortgage credit remains available to millions of credit union members while credit unions all over the country continue to understand how to implement the most sweeping regulatory changes to mortgage lending in U.S. history, and would be welcome relief to credit unions. We encourage Congress either through this legislation or as a separate bill to address this issue.

In addition to addressing the compliance dates of the mortgage regulations, we encourage the Committee to address several other areas of the mortgage regulations, including the definition of points and fees for the purposes of the CFPB's ability-to-repay rule, the credit risk retention requirements for the "qualified residential mortgage" rule and changes to the qualified mortgage rule.

We note that legislation has been considered which would exclude from the definition "all title charges, regardless of whether they are charged by an affiliated company, provided they are bona fide and reasonable." Defining points and fees in this way will maintain a competitive marketplace, prevent over-pricing or limited choice in low-moderate income areas and allow consumers to enjoy the existing benefit of working through one entity for their new mortgage or refinance. A statutory revision would make this definition clearer and stronger than the CFPB's amended rule.

We hope the Committee will also consider including language in the housing finance reform bill to repeal the credit risk retention requirement in the "qualified residential mortgage" rule, and to allow the consumer to waive the requirement that mortgage disclosures be provided to the consumer three business days before closing.

Finally, we encourage the Committee to consider language to repeal the defense to foreclosure provision of the Dodd–Frank Act. The litigation risk created by the defense to foreclosure provision has caused many credit unions to worry that prudential examiners will severely restrict the ability of credit unions to keep non-QM loans that do not enjoy the QM rule's safe harbor in their portfolio after the rule goes into effect. This would make QM the effective requirement for safety and soundness and risk mitigation purposes. These changes would do a great deal to alleviate the very real concern of credit unions that they will not be able to offer mortgages to their members who do not meet all of the QM standards but who nevertheless have the ability to repay a mortgage loan. These changes will also help facilitate the kind of creative products that are possible through portfolio lending that individualize the process of getting a mortgage based on the individual circumstances of each member.

Conclusion

We are encouraged that the Committee has engaged in a process to consider comprehensive housing finance reform. Unquestionably, the housing finance system is in need of repair. A conservatorship is not meant to last nearly a decade. It is critical that Congress get reform legislation right as it impacts the overall economy and perhaps more importantly, the housing needs of Americans. We appreciate that the Committee has sought our views on this legislation and look forward to providing continued assistance as the legislation moves through the process. On behalf of America's credit unions and their 110 million members, thank you for your consideration of our views.

PREPARED STATEMENT OF JACK E. HOPKINS

PRESIDENT AND CHIEF EXECUTIVE OFFICER, CORTRUST BANK, N.A., MITCHELL, SOUTH DAKOTA, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

JULY 20, 2017

Chairman Crapo, Ranking Member Brown, Members of the Committee, my name is Jack E. Hopkins and I am President and CEO of CorTrust Bank in Sioux Falls, South Dakota. CorTrust is a national bank with more than $780 million in assets. As a third-generation community banker, I am pleased to testify today on behalf of the Independent Community Bankers of America and nearly 5,000 community banks nationwide at this important hearing on "Housing Finance Reform: Maintaining Access for Small Lenders". We are grateful for your recognition of the critical importance of preserving community bank access in any reforms to the housing finance system. ICBA strongly supports reform, but it is essential to borrowers and the broader economy that the details of reform are done right. ICBA looks forward to providing ongoing input on the impact of reform on community banks and their customers.

Community Banks and the Mortgage Market

Community bank mortgage lending is vital to the strength and breadth of America's housing market. Community banks represent approximately 20 percent of the mortgage market, but more importantly, our mortgage lending is often concentrated in the rural areas and small towns of this country, which are not effectively served by large banks. For many rural and small-town borrowers, a community bank loan is the only option to help families buy a home.

A vibrant community banking sector makes mortgage markets everywhere more competitive, and fosters affordable and competitive interest rates and fees, better customer service, and more product choice. The housing market is best served by a diverse group of lenders of all sizes and charter types. Nearly 8 years after the financial crisis, an already concentrated mortgage market has become yet more dangerously concentrated. We must promote beneficial competition and avoid further consolidation and concentration of the mortgage lending industry.

CorTrust Bank was founded in 1930, at the outset of the Great Depression, and was built, tested and proven under historically challenging economic conditions. We survived the Great Depression and numerous recessions since that time, including the most recent financial crisis, by practicing conservative, commonsense lending and serving our community through good times and bad. We emerged from the crisis well-capitalized and our lending has supported the recovery. CorTrust Bank serves 19 communities in South Dakota and Minnesota, from Sioux Falls to rural communities with populations of less than 140, such as Artesian, where we were first chartered under the name Live Stock State Bank.

Many American community banks have similar stories—some have been in business for more than 100 years. I fully expect the community bank business model will thrive in the future, to the benefit of consumers, communities, and the broader economy.

Residential mortgage lending has been an important component of CorTrust's business since its founding and has grown more important over the years. In 1988, we first began to sell mortgages into the secondary market to access additional funding. Today, we have a $590 million portfolio consisting of approximately 5,500 loans. About two thirds are held by Fannie Mae, and a smaller number are held by Freddie Mac and by the South Dakota Housing Authority. CorTrust bank and our customers depend on our access to Fannie Mae and Freddie Mac.

Fair Access to the Secondary Market

Secondary market sales are a significant line of business for many community banks. According to an ICBA survey, nearly 30 percent of community bank respondents sell half or more of the mortgages they originate into the secondary market.[1] When community banks sell their well-underwritten loans into the secondary market, they help to stabilize and support that market. Community bank loans sold to Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (the GSEs) are underwritten as though they were to be held in the bank's portfolio. Selling loans to the GSEs allows the community bank to retain the servicing on those loans, thereby keeping their relationship with that borrower. Loans that are serviced by locally based institutions tend to lead to better outcomes for borrowers and their commu-

[1] ICBA Mortgage Lending Survey. September 2012.

nities. Many non-GSE secondary market investors require transfer of servicing when they purchase a loan.

While community banks choose to hold many of their loans in portfolio, it is critical for them to have robust secondary market access to support lending demand with their balance sheets. Selling mortgage loans into the secondary market frees up capital for more residential mortgages or other types of lending, such as commercial and small business lending, which support economic growth in our communities.

Even those community banks that hold nearly all of their loans in portfolio need to have the option of selling loans in order to meet customer demand for long-term fixed-rate loans. Meeting this customer demand is vital to retaining other lending opportunities and preserving the relationship banking model. As a community bank, it is not feasible for me to use derivatives to offset the interest rate risk that comes with fixed-rate lending. Secondary market sales eliminate this risk. The ability to sell a single loan for cash, not securities, is critical to my bank because I don't have the lending volume to aggregate loans and create mortgage backed securities, before transferring them to Fannie Mae or Freddie Mac. In addition, I'm assured that the GSEs won't appropriate data from loans I've sold to solicit my customers with other banking products.

Recapitalization of the GSEs Cannot Wait

Before discussing reforms to the secondary market, I would like to highlight for this committee an immediate risk facing the GSEs, the mortgage market, and taxpayers.

Though Fannie Mae and Freddie Mac have returned to profitability and have resolved the majority of their defaulted loans, the quarterly sweep of their earnings to the Treasury—some $265 billion in 8 years—has seriously depleted their capital buffers. In fact, Fannie Mae and Freddie Mac have less capital today than when they were placed in conservatorship 8 years ago and, absent a change in policy, are on track to fully deplete their capital by year end. When this happens, one or both companies are likely to require a draw from the Treasury. This in turn could trigger a market disruption that spikes interest rates and freezes home purchases and refinancing. This self-inflicted crisis can and must be avoided. FHFA and the Treasury should protect taxpayers from another bailout.

Key Features of a Successful Secondary Market

The stakes involved in getting housing-finance market policies right have never been higher. Housing and household operations make up 20 percent of our economy and thousands of jobs are at stake.

ICBA's approach to GSE reform is simple: use what's in place today and is working and focus reform on aspects of the current system that are not working or that put taxpayers at risk. If reform is not done right, the secondary market could be an impractical or unattractive option for community banks. Proposals that would break up, wind down, sell or transfer parts of the GSEs' infrastructure to other entities would end up further concentrating the mortgage market in the hands of the too-big-to-fail players, putting taxpayers and the housing market at greater risk of failure. Further they run the risk of disrupting liquidity in the $5 trillion housing market that community banks and homebuyers depend on.

Below are some of the key principles community banks require in a first-rate secondary market.

- *The GSEs must be allowed to rebuild their capital buffers.* ICBA believes the first step in GSE reform must be restoring the GSEs to a safe and sound condition. Regardless which approach or structure reform takes, the existing system must be well capitalized to prevent market disruption or additional taxpayer support in the event of one or both GSEs requiring a draw from the U.S. Treasury during what's likely to be a lengthy debate and transition period to any new structure or system.
- *Lenders should have competitive, equal, direct access on a single-loan basis.* The GSE secondary market must continue to be impartial and provide competitive, equitable, direct access for all lenders on a single-loan basis that does not require the lender to securitize its own loans. Pricing to all lenders should be equal regardless of size or lending volume.
- *An explicit Government guarantee on GSE MBS is needed.* For the market to remain deep and liquid, Government catastrophic loss protection must be explicit and paid for through the GSE guaranty fees, at market rates. This guarantee is needed to provide credit assurances to investors, sustaining robust liquidity even during periods of market stress.

- *The TBA market for GSE MBS must be preserved.* Most mortgage lenders are dependent on a liquid to-be-announced (TBA) market that allows them to offer interest rate locks while hedging interest rate risk with GSE mortgage-backed securities (MBS) that will be created and delivered at a later date. Creating new GSE MBS structures, or using customized capital markets structures that provide front end credit risk transfers, generally makes the resulting MBS "non-TBA."
- *Strong oversight from a single regulator will promote sound operation.* Weak and ineffective regulation of the GSEs enabled them to stray from their primary mission as aggregators, guarantors, and securitizers. As required by HERA, the FHFA must ensure the secondary market operates in a safe and sound manner so taxpayers are not put at risk. It is incumbent upon FHFA to ensure the GSEs are adequately capitalized commensurate with their risks and compliant with their primary mission.
- *Originators must have the option to retain servicing, and servicing fees must be reasonable.* Originators must have the option to retain servicing after the sale of a loan. In today's market, the large aggregators insist that lenders release servicing rights along with their loans. Transfer of servicing entails transfer of customer data which can be used for cross-selling. While servicing is a low-margin business, it is a crucial aspect of the relationship-lending business model, giving originators the opportunity to meet the other lending or financial services needs of their customers. Additionally, in general, consumers receive better service when their loans are serviced on a local level than when they are serviced by entities that did not originate their loan and are located out of their market area.
- *Complexity should not force consolidation.* Under the current GSE model, selling loans is relatively simple. Sellers take out commitments to sell loans on a single-loan basis and are not required to obtain complex credit enhancements, except for private mortgage insurance for loans exceeding 80 percent loan-to-value or other guarantees. Any future secondary market/GSE structure must preserve this relatively simple process for community banks and other small lenders that individually do not have the scale or resources to obtain and manage complex credit enhancements from multiple parties.
- *GSE shareholder rights must be upheld.* Any reform of the housing finance system must address the claims of GSE shareholders and respect the rule of law that governs the rights of corporate shareholders.

ICBA's Way Forward

ICBA's approach to GSE reform is simple: use what is in place today and is working, and address or change the parts that are not. Our approach has two parts: reforms that can be accomplished administratively by FHFA within HERA, and reforms that will require Congressional action.

Administrative Reforms

- FHFA should end the net worth sweep of revenues to Treasury and, following HERA, require both GSEs to develop capital restoration plans. These plans would include continued use of credit risk transfers, provided they meet a targeted economic return threshold that balances GSE revenue and capital building needs with prudent credit risk management standards.
- FHFA should review and approve those capital plans, establish prudent risk based capital levels as required by HERA, and set reasonable timeframes and milestones for achieving re-capitalization goals.
- FHFA should monitor the GSEs' performance against their respective plans and release each GSE from conservatorship as they become well-capitalized.
- The GSEs should complete construction of the Common Securitization Platform and issue their respective MBS from the platform. Ownership/management of the CSP should remain with the GSEs through the current LLC structure. Expanding access to the CSP to other entities should be up to Common Securitization Solutions, LLC (CSS) board, with final approval by FHFA.
- Launch of the Uniform Mortgage Backed Security (UMBS) should be deferred until both GSEs are recapitalized and released from conservatorship.

Legislative Reforms

- Congress should create a catastrophic mortgage insurance fund to be administered by the FHFA which would be funded through GSE guaranty fees. The size of the fund should be determined based on actuarial standards and should be similar to the FDIC's deposit insurance fund. The fund would stand behind the explicit U.S. Government guarantee of the GSE MBS.

- Congress should change the GSE corporate charters from the current Government-chartered, shareholder-owned, publicly traded companies, to regulated financial utilities that are shareholder owned. All current shareholders should be able to exchange common and junior preferred GSE shares for a like amount of shares in the new structures. The Treasury should exercise its warrants for senior preferred shares of GSE stock and convert those shares to stock in the new structure. No dividends should be paid to any shareholders until the company is deemed well capitalized per its recapitalization plan by the FHFA. The Treasury should be required to divest itself from its shares once a company is well capitalized.

The worst outcome in GSE reform would be to allow a small number of megafirms to mimic the size and scale of Fannie and Freddie under the pretense of creating a private sector solution strong enough to assure the markets in all economic conditions. Moral hazard derives from the concentration of risk, and especially risk in the housing market because it occupies a central place in our economy. Any solution that promotes consolidation is only setting up the financial system for an even bigger collapse than the one we've just been through.

The GSEs must not be turned over to the firms that fueled the financial crisis with sloppy underwriting, abusive loan terms, and an endless stream of complex securitization products that disguised the true risk to investors while generating enormous profits for the issuers. These firms must not be allowed to reclaim a central role in our financial system.

ICBA is pleased to see a robust debate emerging on housing finance reform. A number of serious proposals have been put forth to date—both from within Congress and from outside—all of which combine promising features with others that warrant additional consideration and reworking.

Closing

Thank you again for the opportunity to testify today. It is critically important the details of reform are done right to ensure community banks and lenders of all sizes are equally represented and communities and customers of all varieties are served.

PREPARED STATEMENT OF CHUCK PURVIS

PRESIDENT AND CHIEF EXECUTIVE OFFICER, COASTAL FEDERAL CREDIT UNION, RALEIGH, NORTH CAROLINA, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERALLY INSURED CREDIT UNIONS

JULY 20, 2017

Introduction

Good morning, Chairman Crapo, Ranking Member Brown, Senator Tillis, and Members of the Committee. My name is Chuck Purvis and I am testifying today on behalf of the National Association of Federally Insured Credit Unions (NAFCU). I appreciate the opportunity to share NAFCU's views on Housing Finance Reform and the importance of maintaining secondary market access for small lenders. NAFCU appreciates the bipartisan approach committee leadership and members have demonstrated on this critical issue. In addition to our testimony, NAFCU member credit unions look forward to continuing to work with you beyond today's hearing to ensure access to the secondary mortgage market for credit unions and their 110 million members.

I currently serve as the President and CEO of Coastal Federal Credit Union in Raleigh, North Carolina. Coastal Federal Credit Union is a $2.9 billion institution serving 235,000 members with 22 branches in central North Carolina. Coastal was originally chartered in August of 1967 to serve employees of IBM in Raleigh. Today, we offer our employer groups a full range of financial products and services, including checking accounts, deposit accounts, credit cards, auto loans, mortgages and home equity loans. We also provide a suite of ancillary services, including wealth management and residential real estate brokerage services. In 2016, Coastal received a low income designation from NCUA, meaning at least 50 percent of our members live in census tracts that are identified as being low income by the Federal Government.

I joined the team at Coastal in May of 2001 and became President/CEO on July 1, 2012. I have 35 years of senior management experience with credit unions, including serving on the board and as chairman of the National Credit Union Foundation. I was also recently recognized by the *Triangle Business Journal* as the 2016

Business Person of the Year, the first time that a credit union executive has been honored with that award.

I go to work every day with three things in mind:

1. How can I make Coastal a great place to work for our 475 employees? If they don't enjoy coming to work, find their work rewarding, and love to serve, we will not succeed in providing exceptional service and value to our members;
2. How do we best use our resources to put more money into the pockets of our members every day? They are who we are here to serve; and,
3. How do we help make the dreams of our members come true—whether their first home, first car for a college graduate, or a basic car to allow someone to work every day and support their family? These dreams and aspirations are why we exist.

NAFCU's Perspective on Emerging Senate Debate

NAFCU applauds Chairman Mike Crapo and Ranking Member Sherrod Brown for their continued bipartisan attention to housing policy as the Banking Committee agenda aggressively pursues housing finance reform ideas from the perspective of all stakeholders. NAFCU is the only national organization exclusively representing the interests of the Nation's federally insured credit unions. NAFCU-member credit unions collectively account for approximately 69 percent of the assets of all federally chartered credit unions. My testimony today will explore the longstanding and vital relationships credit unions have with the Government sponsored enterprises (GSEs) and how important it is for any housing finance reform package to ensure credit union access to the secondary market under fair pricing conditions.

We appreciate the approach the committee has taken to not rush any efforts on housing finance reform, and to carefully consider the practical implications of any changes that may be made. Although we have not endorsed any particular plan at this time, we appreciate the stakeholder focused approach and the Committee holding this hearing. We do, however, have several housing finance reform principles that should be included in any reform effort to guarantee the continued safety and soundness of the credit union industry.

We believe that efforts to fund a new system be done in a way as to limit the cost to smaller financial institutions as much as possible. High costs of entry into, or establishment of, a new system, could be a major barrier of access for small lenders. To date, we do not believe that any housing finance reform solution suggested in previous Congresses fully took into account the needs of small lender access. For instance, the legislation before the Committee in 2014, S. 1217, had a $15 billion cap for participation in a new mutual securitization company designed for smaller lenders. With that model, we remain concerned that institutions below that arbitrary asset size threshold would be unable to generate enough volume to ensure liquidity and that smaller lenders would have a difficult time capitalizing such an entity. If the Committee were to consider such an approach again, we believe it should be open to a full range of institutions to ensure that these concerns are addressed.

We also want to stress that it is critical that large institutions not be given control of the market. Even though large institutions play an important role, including serving as a loan purchaser for small lenders, their market dominance would have negative consequences for smaller institutions. In many instances, they compete for mortgage business with small lenders. They may be willing to buy small lender loans to package them in good economic times, ensuring liquidity for small lenders. However, in an economic downturn, they may limit this activity, drying up liquidity for small lenders and reducing competition for them on the front-end. In that scenario, the consumers and communities small lenders serve lose access to mortgage credit. Congress must ensure that does not happen in a reformed system.

Credit Union Principles in Housing Finance Reform Efforts

Recently, as the future of housing finance has become a focal point in Congress, with the Administration and among regulatory agencies, NAFCU established an updated set of principles that the association would like to see reflected in any reform efforts. The objective of these principles (listed below) is to help ensure that credit unions are treated fairly during any housing finance reform process. The principles are:

- *A healthy, sustainable and viable secondary mortgage market must be maintained.* Credit unions must have unfettered, legislatively guaranteed access to the secondary mortgage market. In order to achieve a healthy, sustainable and viable secondary market, there must be vibrant competition among market participants in every aspect of the secondary market. Market participants should include, at a minimum, at least one GSE, the Federal Home Loan Banks (FHLBs), Ginnie Mae, and private entities.

- *The U.S. Government should issue an explicit Government guarantee on the payment of principal and interest on mortgage-backed securities (MBS).* The explicit guarantee will provide certainty to the market, especially for investors who will need to be enticed to invest in MBS, and facilitate the flow of liquidity through the market.
- *The GSEs should be self-funded, without any dedicated Government appropriations.* Although the U.S. Government should be involved in the secondary mortgage market, the GSEs should not be Government-funded mortgage programs. The GSEs' fees should provide the revenue necessary for sustained independent operation. Those fee structures should, in addition to size and volume, place increased emphasis on the quality of loans. Risk-based pricing for loan purchases should reflect that quality difference. Credit union loans provide the high quality necessary to improve the salability of the GSEs' securities.
- *Creation of a FHFA board of advisors.* A board of advisors made up of representatives from the mortgage lending industry should be formed to advise the FHFA regarding the GSEs and the state of the secondary mortgage market. Credit unions should be represented in such a body.
- *The GSEs should be allowed to rebuild their capital buffers.* Rebuilding capital buffers ensures the safety and soundness of the GSEs, maintains investor confidence, prevents market disruption, and reduces the likelihood of another taxpayer bailout in the event of a future catastrophic market downturn. The GSEs should be permitted to begin rebuilding capital slowly over a period of several years.
- *The GSEs should not be fully privatized at this time.* There continues to be serious concerns that in a fully privatized system, in which the GSEs are sold off to the secondary market, small, community-based financial institutions could be shut out of the secondary market. Any privatization efforts should be gradual and ensure that credit unions have continued access to the GSEs and the secondary mortgage market.
- *The FHLBs must remain a central part of the mortgage market.* The FHLBs serve an important function in the mortgage market as they provide their credit union members with a reliable source of funding and liquidity. Housing finance reform must take into account the consequence of any legislation on the health and reliability of the FHLBs.
- *Credit risk transfer transactions should be expanded and the Common Securitization Platform (CSP) and Single Security retained.* Although there are concerns regarding credit unions' ability to participate in certain credit risk transfer (CRT) transactions, the GSEs should continue to expand CRT as well as initiatives to create deeper mortgage insurance to further disperse risk among private investors. Credit unions should be permitted to participate in transactions such as front-end CRTs through a special purpose vehicle, such as a credit union service organization or the FHLBs. The CSP and Single Security have the potential to simplify the sale of loans to the GSEs and allow greater, more affordable access to the secondary mortgage market.
- *The FHFA or its successor should continue to provide strong oversight of the GSEs and the new system, whatever it may look like.* A strong, reliable single Federal regulator helps to provide consistency and focus to the GSEs so they can stay on track with their core missions and objectives. The FHFA helps maintain safety and soundness in the secondary mortgage market. A new system should also utilize the current regulatory framework and GSE pricing and fee structures.
- *The transition to a new system should be as seamless as possible.* Regardless of whether the GSEs in their current form are part of a new housing finance system, credit unions should have uninterrupted access to the GSEs or their successor(s) and the secondary mortgage market as a whole, in particular through the cash window and small pool options.

Background on Credit Unions and Credit Union Mortgage Lending

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the Federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 §U.S.C. 1752(1)). Congress established credit unions as an alternative to banks and to meet a precise public need-a niche credit unions fill today for nearly 110 million Americans. Despite the passage of over 80 years since the Federal Credit Union Act (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

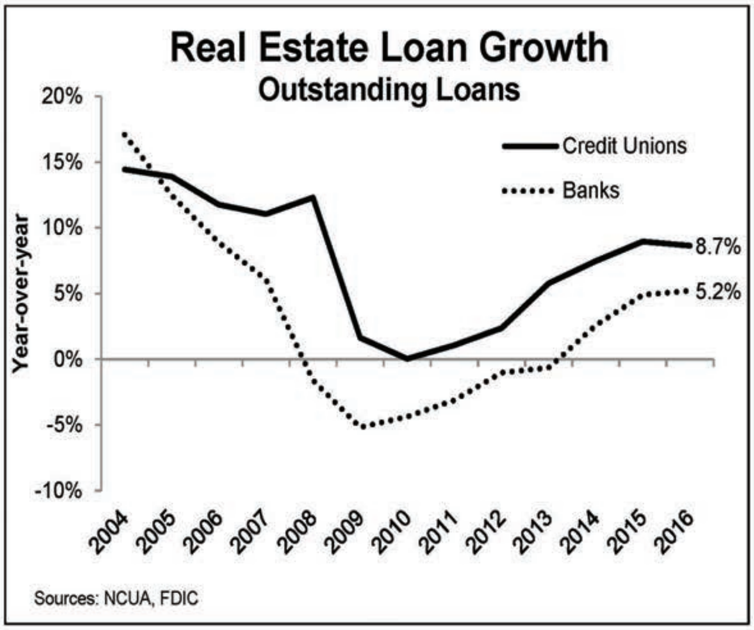
- Credit unions remain totally committed to providing their members with efficient, low-cost, personal financial service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism. Credit unions are not banks.

The Nation's approximately 5,700 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions, united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, Federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. Since the financial crisis of 2008, consolidation of the commercial banking sector has progressed at an increasingly rapid rate. With the resulting depersonalization in the delivery of financial services by banks, the emphasis in consumers' minds has begun to shift not only to services provided, but also—more importantly—to quality and cost of those services. Credit unions are second-to-none in providing their members with quality personal financial services at the lowest possible cost.

As has been noted by members of Congress across the political spectrum, credit unions were not the cause of the economic crisis, and an examination of their lending data indicates that credit union mortgage lending outperformed bank mortgage lending during the recent downturn. This is partly because credit unions did not contribute to the proliferation of sub-prime loans. Before, during, and after the financial crisis, credit unions continued to make quality loans through sound underwriting practices focused on placing their members in solid products they could afford.

While the housing market continues to recover from the financial crisis, and Congress works to put into place safeguards to ensure such a crisis never happens again, credit unions continue to focus on providing their member-owners with the basic financial products they need and demand. The graphs below highlight how credit union real estate loan growth has outpaced banks since the downturn and how credit unions have fared better with respect to real estate delinquencies and real estate charge-offs. It is with this data in mind that NAFCU urges members of the Committee to recognize the historical performance and high quality of credit union loans as housing finance reform moves forward.


Real Estate Loan Growth
Outstanding Loans
20%
15%
10%
5%
0%
-5%
-10%
Year-over-year
Credit Unions
Banks
8.7%
5.2%
2004
2005
2006
2007
2008
2009
2010
2011
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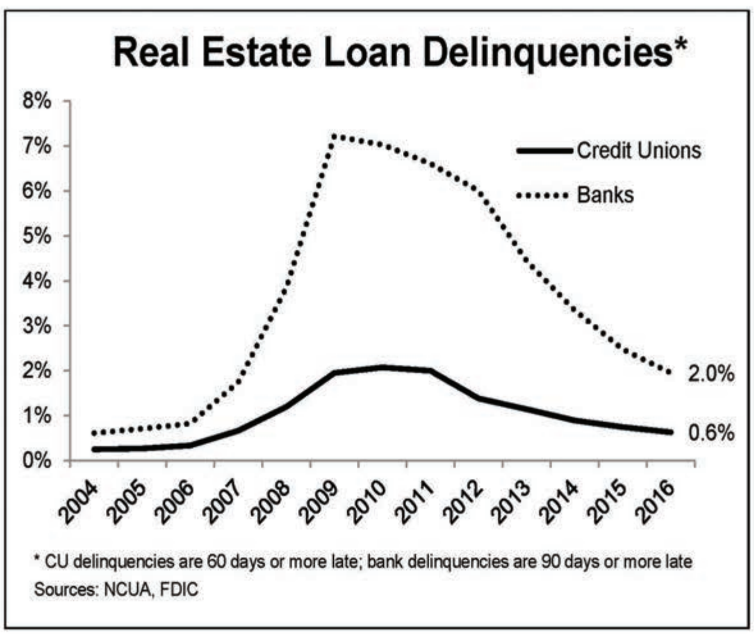
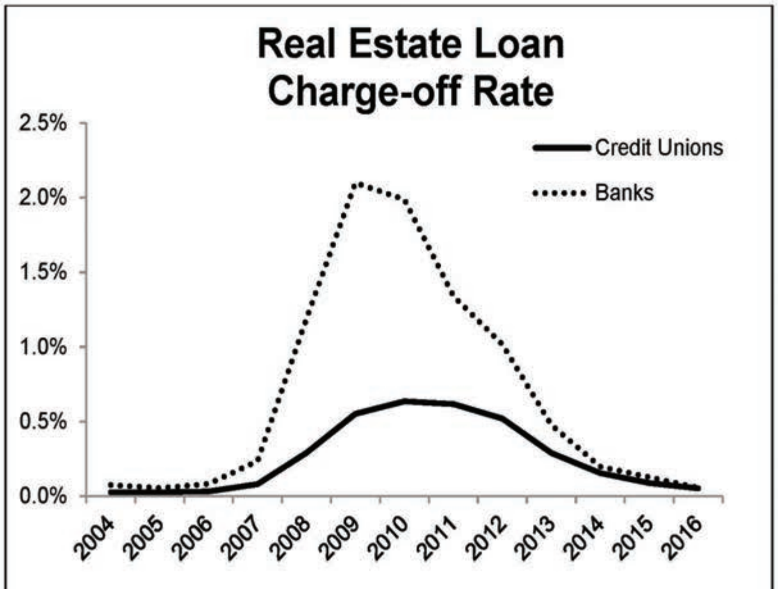
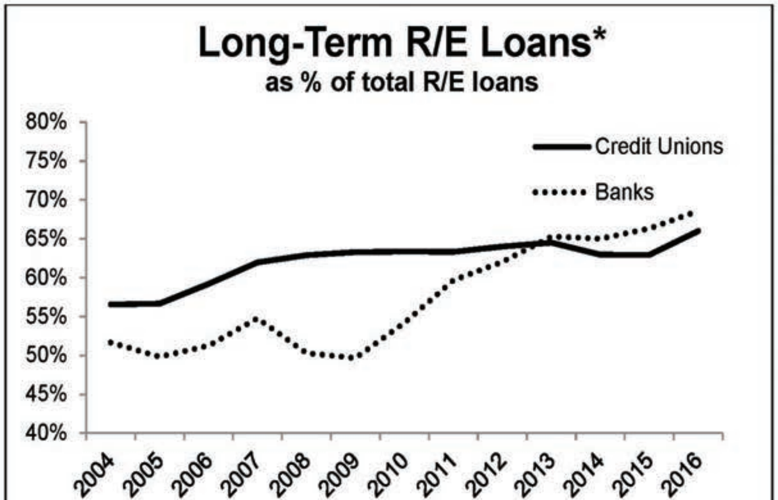
2016
Sources: NCUA, FDIC


Real Estate Loan Delinquencies*
8%
7%
6%
5%
4%
3%
2%
1%
0%
Credit Unions
Banks
2.0%
0.6%
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
* CU delinquencies are 60 days or more late; bank delinquencies are 90 days or more late
Sources: NCUA, FDIC



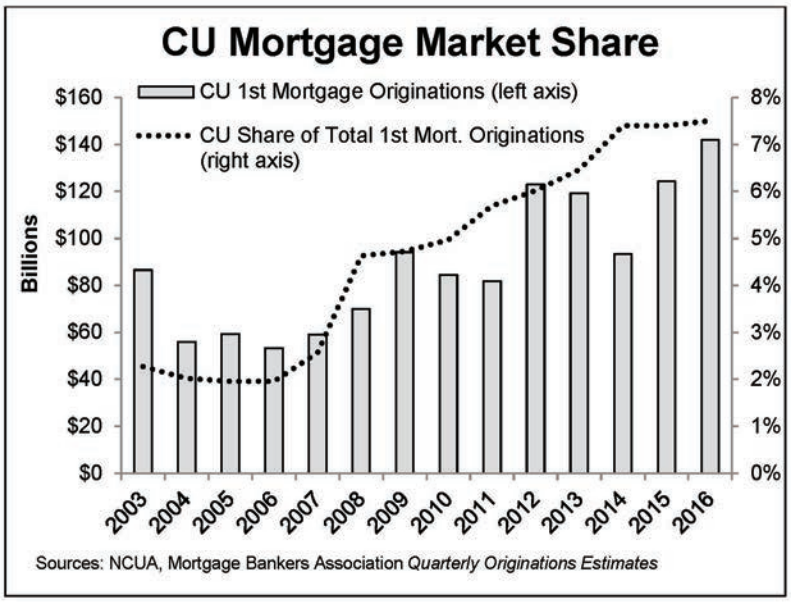
Sources: NCUA, FDIC



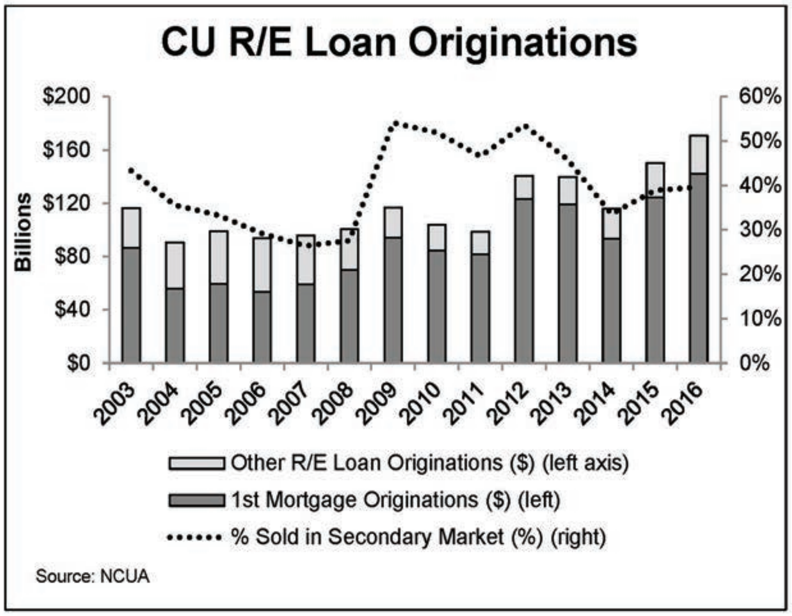
* For CUs, real estate loans outstanding less the amount of real estate loans outstanding that will contractually refinance, reprice or mature within 5 years. For banks, closed-end first mortgages on 1-4 family properties with maturity greater than 5 years.

Sources: NCUA, FDIC

A primary concern of credit unions is continued unencumbered access to the secondary mortgage market. This includes adequate transition time to any new system. A second concern, equally as important, is recognizing the quality of credit union loans through a fair pricing structure. Because credit unions originate a relatively low number of loans compared to others in the marketplace—federally insured credit unions had just over 7 percent of the first mortgage originations in 2016 (see chart below)—we do not support a pricing structure based on loan volume, institution asset size, or any other geopolitical issue that will lend itself to discrimination and disadvantage their member-owners. As such, credit unions should have access to pricing that is focused on quality not quantity.

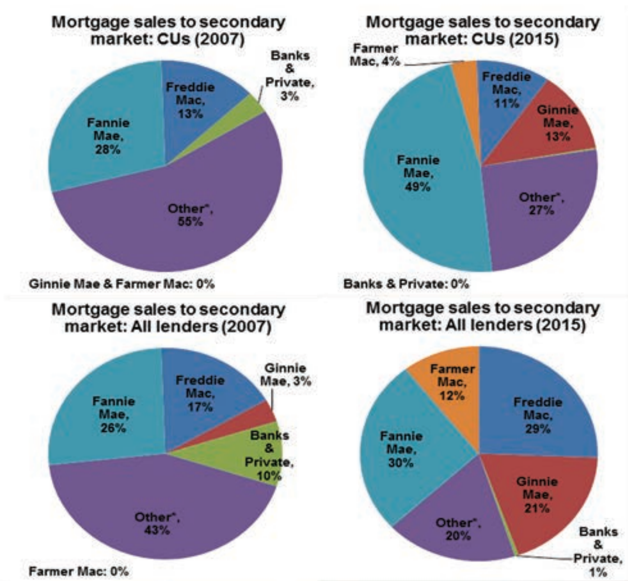


Recent trends in asset portfolios, coupled with the current interest rate environment, present a unique challenge to credit union management. Until recently, interest rates had fallen to record lows, credit unions experienced vigorous share growth, and credit union participation in the mortgage lending arena increased to historic heights. Even as interest rates have begun to rise again, credit union first mortgage originations have continued to grow. Between 2007 and 2016, the credit union share of first mortgage originations expanded from 2.6 to 7.5 percent. The portion of first mortgage originations sold into the secondary market increased overall from 26 percent in 2007 to 40 percent in 2016, according to National Credit Union Administration (NCUA) call report data (see chart below), although it has leveled off in recent years.



Credit unions hedge against interest rate risk in a number of ways, but selling products to be securitized and sold on the secondary market remains a key component of safety and soundness. Lenders must have guaranteed access to secondary market sources including Fannie Mae, Freddie Mac, Ginnie Mae, and the Federal Home Loan Banks (FHLBs) as they are valuable partners for credit unions who seek to hedge interest rate risks by selling their fixed-rate mortgages. Not only does this allow credit unions to better manage risk, but we are also able to reinvest those funds into their membership by offering new loan products or additional financial services. A 2015 NAFCU real estate survey highlights the growing use of GSEs among credit unions. More than three-quarters of respondents indicated that credit union board policy restricted the percentage of real estate loans that could be held on their balance sheet, with a median limitation of 40 percent of total loans. Without these critical relationships, credit unions would be unable to provide the services and financial products their memberships demand and expect.

Home Mortgage Disclosure Act data shows how heavily credit unions have come to rely on the GSEs. Between 2007 and 2015, the portion of credit union first mortgages that were sold to Fannie Mae grew from 28 percent to 49 percent. The portion sold to Freddie Mac fell slightly from 13 percent to 11 percent over the same period. Credit unions sold a total of 60 percent of their first mortgages sold to the secondary market to the GSEs in 2015. The total market for mortgage resales is also heavily dependent on the GSEs. The portion sold to Fannie Mae and Freddie Mac in 2007 was 43 percent in 2007 and 59 percent in 2015.



* Includes credit unions, mortgage banks, finance or life insurance companies, affiliate institutions, and other types of purchasers

Source: FFIEC Home Mortgage Disclosure Act (HMDA) data

Finally, it should also be noted that the Government plays an important role in helping to set standards and bring conformity to the housing market. Any changes to these standards that result in decreased conformity could make it harder for credit unions to sell loans onto the secondary market as they do not have the economies of scale that larger market participants enjoy.

Mortgage Lending at Coastal

Coastal has been offering mortgage loans for the past 40 years. Until 2008, Coastal held the majority of our mortgages in portfolio. As demand grew and long term interest rate risk came into play, we began to work with Fannie Mae to sell many of our loans into the secondary market. From 2008 to 2009, we experienced a 300 percent increase in the value of loans sold to Fannie Mae.

It's important to note that Coastal never participated in the type of risky mortgage lending that contributed to the economic downfall of 2008 and 2009. We did not get into negative amortizing ARMs, ALT-A loans, subprime loans, or "no income, no job, no assets (NINJA)" loans. The demand existed. We had members who asked for these types of loans, but we took our fiduciary responsibility to our members seriously and would not put them into a home they could not realistically afford. As a result, we only experienced 70 foreclosures over the past decade, including a period of time where other lenders saw double-digit percentages of their portfolio going bad.

Since 2011, Coastal has made more than 11,700 mortgage loans, for a total $2.25 billion. During that same time period, we sold 72 percent of those loans directly to Fannie Mae, because they offer competitive pricing for affordable lending to our members, diverse mortgage products, and allow us to maintain the servicing relationship with our members.

We currently service 10,738 mortgages valued at nearly $1.8 billion. Of that, 7,310 loans valued at $1.2 billion are with Fannie Mae. To us, these are more than just loans. Each one represents a family in a home, and each mortgage application is a new opportunity to help make a family's dream of home ownership come true. Even though most of our mortgage business is within central North Carolina, we do have members in all 50 States.

Within our primary 16-county market footprint, Coastal ranks 10th in market share out of 620 lenders. We achieve this, in part, because of the trust we've built with our membership and the value we return to them. We receive volumes of positive feedback from our members in regard to our mortgage process and our servicing.

We firmly believe that access to affordable credit for homebuyers is essential to middle class financial well-being. Even people who rent can benefit. We represent a market that's home to some of the highest rents in the State, in part due to supply constraints in a high-demand market. By continuing to make home loans accessible and affordable, we can help do our part to relieve some of that market pressure.

But, without the GSEs, our capacity to lend would be outstripped by demand. The GSEs benefit consumers because access to the secondary market and access to capital provides us with additional lending capacity. Our ability to sell loans, versus keeping them on our balance sheet, also mitigates our long term interest rate risk, reduces concentration risk, and keeps rates competitive. If not for access to the GSEs, our capacity to meet local demand would be greatly diminished, and local consumers would suffer from higher rates and fees, more stringent credit requirements and overall fewer options. I urge you to keep this in mind as you consider reform.

Coastal serves many members who are seeking to buy their first home. We feel an obligation to help make that first mortgage affordable, and are committed to walking members through the home-buying process. We offer a variety of seminars and educational resources for first-time homebuyers, including Fannie Mae's Framework.

Coastal has been making special first-time homebuyer loans since the 1990s. We currently offer two first-time homebuyer mortgages, a 30-year fixed-rate loan and a 7/1 adjustable rate loan. The program is available to home buyers who have not owned a home in the last 3 years. The product conforms to Fannie's standards, so only one spouse needs to be a first-time home buyer. Our first-time homebuyer mortgage is a 100 percent loan with no mortgage insurance, no income or area limits and up to a $300,000 sale price. We currently service 787 first-time homebuyer loans, totaling $124 million. Our 60-day delinquency rate on those loans is below 1 percent.

In 2016, due to the increasing number of extended and multi-generational households in our market, we began offering the Fannie Mae HomeReady® loan. HomeReady® allows consideration of income from non-borrower household members (relatives or non-relatives) as a compensating factor to allow for a debt-to-income (DTI) ratio above 45 percent and up to 50 percent. It also considers non-occupant borrowers, such as parents.

We are also a member of the Federal Home Loan Bank of Atlanta, and through them, we have access to additional funding to allow us to continue to make home loans at times where loan demand outstrips deposit growth. Currently, we have $110 million outstanding with the FHLB.

Term advances from the FHLB are also a tool to help us manage interest rate risk created by longer term loans.

Key Elements of the Current System

Our partnership with Fannie Mae is critical to Coastal's mortgage lending function. We use Fannie's Desktop Underwriter® platform to underwrite all mortgage loans that we originate. This ensures conformity and consistency across our portfolio, whether we sell the loan or not.

Our reliance on Desktop Underwriter® provides Coastal with a level of efficiency that we might not otherwise have. Additionally, it enhances the member experience by automating and expediting parts of the loan process. If governmental reform creates any significant changes to the Desktop Underwriter® platform, it would have widespread effects on our operations.

Fannie Mae has recently launched a new program, Day One Certainty™, which automates and expedites income and employment verification as part of the application process. This speeds up the mortgage underwriting process by as much as ten business days, adds a level of data integrity, and greatly reduces the risk of fraud. Coastal participated in the pilot program for Collateral Underwriter® for property evaluations, one of four segments of the Day One Certainty™ program.

As Congress considers reform, access to such technology must be preserved in any new model. The GSEs' tools provide critical benefits to small lenders. Desktop Underwriter® and Day One Certainty™ are important tools for Coastal and we want to ensure stability with these platforms. There are some opportunities for improvement, including updating the Agency's antiquated credit risk scoring platform, which would subsequently lessen some punitive results in loan level pricing adjustments borne by the consumer.

The current aggregation model at the GSEs has also had benefits for credit unions. We do not want to see a regression to the previous aggregation model used before conservatorship—where market share agreements with the largest lenders created underwriting exceptions and lower guarantee fees based on volume, not on the underlying loan risk. This priced out smaller lenders and forced them to sell to larger lenders, instead of directly to Fannie Mae. These practices created huge volumes of underpriced risk that were a part of the culture and precipitated the financial crisis. We want a system that ensures equal market access for lenders of all sizes and business models and maintains a deep, liquid market for long-term options. Furthermore, even though Coastal is not currently using it, the function of the cash window at the GSEs as a single loan execution process is also vital to credit unions moving forward.

Transition to a New Housing Finance System

Should Congress act to reform the Nation's housing finance system, getting the transition right will be critical. More than anything, to ensure a smooth transition to a reformed system, credit unions need certainty that changes outlined in legislation and accompanying regulation will function as intended. Credit unions must be kept up-to-date during this transitional period and lawmakers should build flexibility into the transitional period to account for unforeseen implementation challenges. NAFCU believes that Congress should first agree on a set of reforms and then, based on the nature and complexity of such reforms, establish a timeframe for transition. Arbitrarily pledging to adhere to a transitional timeframe before a set of reforms are agreed upon could create otherwise avoidable issues for new entities created under any proposal and outside stakeholders.

In an effort to ease the transition, Congress should consider moving currently approved Fannie and Freddie lenders into a new system en bloc and giving them an expedited certification. This could reduce confusion and, if executed properly, could make the process run more smoothly for all involved. It can take time for lenders to be certified with the GSEs, and this time to certify, whether to the GSEs or to a new system, should be factored in to the transition time.

NAFCU also believes it is important that a new system be up and running before Fannie Mae and Freddie Mac's ability to securitize MBS is shut down. One way to accomplish this may be to have the two entities exist in a winding down capacity during the early stages of a new system.

The Importance of Servicing Rights to Credit Unions

Any new housing finance system must contain provisions to ensure credit unions can retain servicing rights to loans they make to their members. Many consumers turn to credit unions for lower rates and more palatable fee structures, but they also want to work with a reputable organization they trust will provide them with high quality service. Because credit unions work so hard to build personal relationships with their members, relinquishing servicing rights has the potential to jeopardize that relationship in certain circumstances.

At Coastal, we retain servicing rights on all of our loans. This was especially beneficial during the economic crisis, as it allowed our members to approach us when they got in trouble and allowed us to work with them on their loan and keep them in their home.

Underwriting Criteria in Any New System

NAFCU has concerns about using the "Qualified Mortgage" (QM) standard as the standard for loans to be eligible for the Government guarantee, as was proposed in previous legislation before the Committee. We believe underwriting standards may be best left to the new regulator and do not think that they should be statutorily established. Doing so would allow the regulator to address varying market conditions and act in a countercyclical manner if needed.

Furthermore, given the unique member-relationship credit unions have, many make good loans that work for their members that do not fit into all of the parameters of the QM box. Using the Consumer Financial Protection Bureau's (CFPB) QM standard for the guarantee would continue to discourage the making of non-QM loans.

We would also like to caution against the perpetuation of the use of one brand of credit scoring model. Both Fannie Mae and Freddie Mac require loans that are underwritten using FICO scoring models. We believe any new system should be open to other possible credit scoring models as well.

Regulatory Relief and Mortgages

NAFCU supports changes to QM standard to make it more amenable to the quality loans credit unions are already making. We would like to highlight two such changes:

Loans Held in Portfolio

NAFCU supports exempting mortgage loans held in portfolio from the QM definition as the lender, via its balance sheet, already assumes risk associated with the borrower's ability-to-repay. The following is a real-life example of a loan we would approve to hold in portfolio that we would not approve now:

- Nonconforming loan (jumbo)
- 53 percent LTV
- Existing long relationship
- Substantial deposit relationship
- 810 FICO score
- DTI is above 43 percent creating a non-QM loan

Debt-to-Income Ratio

NAFCU supports Congress directing the CFPB to revise aspects of the "ability-to-repay" rule that dictates a consumer have a total debt-to-income (DTI) ratio that is less than or equal to 43 percent in order for that loan to be considered a QM. This arbitrary threshold will prevent otherwise healthy borrowers from obtaining mortgage loans and will have a particularly serious impact in rural and underserved areas where consumers have a limited number of options. The CFPB should either remove or increase the DTI requirement on QMs.

We would also support changes to the TILA/RESPA requirements, such as removing the requirement to deliver the Closing Disclosure (CD) 3 business days prior to closing. There are myriad reasons why this issue creates hardship for all involved. A "real-life" situation includes a final property inspection triggering "last minute" changes to the contract that are in the best interest of the borrower. Because of the rigid, mandatory, no exception nature of the requirement, these examples "re-start" the timer and push back closing affecting moving schedules, utility setups, etc. There may also be examples where a borrower may be able to get better terms on rates, but cannot afford to move the closing and cannot waive this requirement.

Another frustration relates to third party fees. The lender is required to know exactly what third parties will charge and if the actual invoice exceeds the tolerance, the lender must pay the difference. Situations arise where an inspection or appraisal may be more involved than originally thought and vendors may justifiably incur more expenses to perform the work. Again, the rigidity of the rules requires the lender to absorb these amounts.

Conclusion

In conclusion, NAFCU appreciates the Banking Committee's bipartisan approach to housing finance reform and the inclusive nature of the process. As you consider reform, we urge you to adhere to the credit union principles outlined in my testimony. Whatever approach is taken to reform the system, it is vital that credit unions continue to have unfettered access to the secondary market and get fair pricing based on the quality of their loans. The Government must also continue to play a role by providing an explicit Government guarantee to help stabilize the market.

Thank you for the opportunity to provide our input on this important issue. NAFCU and our member credit unions look forward to working with you and your staffs as housing finance reform legislation moves through the legislative process.

I thank you for your time today and welcome any questions that you may have.

PREPARED STATEMENT OF WES HUNT

PRESIDENT AND CHIEF EXECUTIVE OFFICER, HOMESTAR FINANCIAL CORPORATION, GAINESVILLE, GEORGIA, ON BEHALF OF THE COMMUNITY MORTGAGE LENDERS OF AMERICA

JULY 20, 2017

On behalf of the Community Mortgage Lenders of America (CMLA) I am pleased to submit testimony to the Senate Committee on Banking, Housing, and Urban Affairs on Housing Finance Reform. CMLA is a trade group representing small lenders that serve the housing finance needs of their customers. CMLA's members, which include both mortgage companies and community banks, are active originators of loans that are sold to, and securitized by, both Fannie Mae and Freddie Mac (collectively the "GSEs").

None of CMLA's members received TARP bailout money and among our members there were very few loans from either GSE or FHA that they were required to repurchase.

CMLA is a member of the Main Street GSE Reform Coalition, which recently published a set of Common Principles for GSE reform. The Common Principles emphasize the need for strong capitalization of the GSEs, equal treatment and access for all lenders and fulfillment of the GSEs' affordable housing obligations.

Summary of CMLA Housing Finance Reform Recommendation

We are pleased that the Committee is moving forward on the subject of housing finance reform. Since the depths of the 2008 financial crisis, the U.S. mortgage market has made great strides in addressing the issues that created and drove the crisis. The last significant piece of unfinished business from the crisis is to resolve the status of Fannie Mae and Freddie Mac. In order to best serve the home finance needs of American consumers we need to allow these two vital sources of liquidity for the home mortgage market to emerge from their nearly 9 year-long conservatorships. Listed below are CMLA's recommendations of how to accomplish the final steps in housing finance reform:

- The Housing and Economic Recovery Act of 2008 (HERA) addressed many of the shortcomings and lapses that led to the financial failure of Fannie and Freddie, and the Qualified Mortgage provision in Dodd–Frank successfully addressed lax underwriting standards and poorly designed products. However, there are a few important steps left to be accomplished;
- The completion of housing finance reform includes both administrative actions and targeted, specific Congressional legislation;
- The Federal Housing Finance Agency (FHFA) must exercise its authority under HERA to set capital standards for the GSEs and oversee and approve the GSEs creating and executing a recapitalization plan to build a strong base of private capital to provide financial stability and reduce taxpayer risk;
- Congress should make permanent the mandate of equal fees for all lenders and the FHFA's authority to regulate the guaranty fees charged by the GSEs as well as extending these two safeguards to upfront risk sharing arrangements as well, in order to ensure a level playing field for America's homebuyers and all lenders, and
- Congress must also provide a Federal backstop for the GSEs, so their MBS will continue to command strong prices in the marketplace, which translate to affordable interest rates for home buyers and continued availability of 30-year fixed-rate loans

State of the Mortgage Market

The state of the mortgage market in the U.S. in 2017 is good with some improvements definitely required. Lenders are projected to originate approximately $1.6 trillion in single family mortgages this year. Home values are on a steadily upward trajectory and many individuals and families are able to obtain financing to purchase their home of choice. Interest rates for a 30-year fixed-rate mortgage remain in the 4 percent range and the credit performance of existing loans is strong.

According to Core Logic, a California-based real estate data and analytics firm, delinquency and foreclosure rates among existing home loans are at quite moderate levels, and down from a comparable period in 2016. Both early (30 day) and late stage delinquencies (120 days+) are down .5 percent since the comparable period in 2016, while loans in foreclosure have declined from 1.0 percent in 2016 to 0.7 percent in 2017. All of these delinquency and foreclosure statistics are a fraction of the comparable numbers during the height of the financial crisis and its immediate aftermath in the 2008–2010 period.

Credit parameters have loosened somewhat in the past year, but remain more stringent than they were early in the century prior to the relaxation that led to the financial crisis. Fannie Mae, for example, recently announced that the maximum debt to income ratio they would accept on loans they purchase, would be 50 percent. Previously the maximum was 45 percent, with 50 percent acceptable only under certain qualifying circumstances.

However, there has been little to no increase in mortgage risk as a result of these modest loosening in credit parameters. As measured by Core Logic's Housing Credit Index, which tracks the risk inherent in mortgages being currently originated, the risk in mortgage being originated today is equivalent to the risk inherent in mortgages originated early in this century, which was a period of low risk and robust credit performance for single family mortgages in the U.S. By comparison the Housing Credit Index in the first quarter of 2007, at the height of the pre-crisis relaxation of underwriting standards and origination of exotic mortgage products, was more than double what it is today.

To be sure, there are some issues in today's market that need to be addressed. Credit parameters, while having loosened somewhat, are still stricter than they were in the 2000–2003 time period. That early 21st century time period is seen as having had the optimum balance between ample credit availability and strong underwriting standards. In addition, the supply of homes, both existing and new, is quite restricted in many major markets. Overhanging all of this is the continued low rate of home ownership, which in turn has contributed to sharp increases in rents as potential buyers remain as tenants and compete for rental housing with new entrants.

A significant, and from the standpoint of small lenders, beneficial change in the mortgage marketplace since the immediate aftermath of the financial crisis has been the lessening of market share concentration among the big bank lenders. In 2011 three big bank lenders accounted for 50 percent of all residential mortgages in the U.S. Today the market share held by those three same banks is just above 20 percent. What has changed is the market share of small and mid-sized independent lenders, which has grown to 40 percent plus in 2016 and the first half of 2017.

The growth in the independent lender segment has translated into more choices for consumers and less risk concentration among a few large lenders, both positives for the marketplace and for borrowers.

State of Mortgage Market Reform

The shortcomings that led to the GSEs' conservatorship are well known. Too little capital, a weak and ineffective regulator, executive compensation that encouraged excessive risk taking and discounted guaranty fees to large lenders that led to a concentration of risk, were the four primary causes. Fortunately, HERA corrected three of these issues and legislative action by Congress in 2011 corrected the fourth, at least temporarily.

HERA created FHFA as a robust regulator, armed with sufficient authority to oversee the operations of the GSEs. The legislative change in 2011 authorized FHFA to regulate the guaranty fee charged by the GSEs and mandated equal guaranty fees for all lenders for a 10-year period ending in October, 2021.

FHFA's actions, as both regulator and conservator we believe, have fulfilled the expectations of HERA's drafters. Under FHFA's direction and control Fannie Mae and Freddie Mac have been steady, dependable and significant sources of liquidity for the conventional mortgage market. The credit quality of the mortgages purchased and securitized by the duo have been outstanding, as has the performance of the mortgages backing the GSE-issued securities. Fannie Mae and Freddie Mac are once again the linchpins of the conventional mortgage market in the U.S.

FHFA has also moved to address some issues that have made the mortgage market less efficient and more expensive for consumers—notably the price difference between Freddie Mac and Fannie Mae securities. As noted recently by the Urban Institute, the price gap between the Freddie Mac and Fannie Mae mortgage backed securities has largely disappeared. This price gap, with Freddie Mac securities commanding a lower price in the capital markets, had persisted for many years, well prior to conservatorship. Now with the product uniformity and other operational efficiencies introduced by FHFA, as well as the promise of a common securitization platform and a single security, have led to the market pricing the securities on a relatively equal basis.

The other major shortcoming that FHFA has not addressed, though HERA provided it with ample authority to do so, is the inadequate capitalization of Fannie Mae and Freddie Mac. HERA authorizes the FHFA Director to set both minimum capital standards and risk-based capital standards, "to the extent needed to ensure that the regulated entities operate in a safe and sound manner."

Unfortunately, with Fannie Mae and Freddie Mac in conservatorship, FHFA has chosen to not exercise its capital authority under HERA. In fact, the Preferred Stock Purchase Agreements (PSPAs) between the U.S. Treasury and each GSE specifically ignore the capital provisions of HERA and require each entity to reduce its capital level each quarter until it reaches zero in January 2018. We find this to be a reckless and ill-advised action put in place by the former administration and we shall address this issue further, later in this testimony.

FHFA has also acted to ensure that executive compensation provides the appropriate incentives to keep GSE management focused on fulfilling their mission of providing ample liquidity to the mortgage market and a flow of affordable housing finance for lenders to make available to consumers.

The fourth shortcoming, the discounting of guaranty fees tied to lending volume, was a serious misstep by Fannie and Freddie. The combination of a 10-year grant of statutory authority to FHFA and strong, effective administrative action, have eliminated this issue.

In the pre-crisis era both Fannie Mae and Freddie Mac utilized the technique of discounted guaranty fees in return for exclusive business arrangements with large lenders as a competitive tool to garner larger loan volumes.

This discounting of guaranty fees to large lenders had several detrimental effects on the financial stability of the GSEs and the mortgage market. Through the discounts the large lender recipients were able to translate their favorable pricing into a competitive advantage in the primary mortgage market that allowed them to underprice small lenders and gain larger market share for themselves. As pointed out above these larger market shares led to a dangerous concentration of mortgage originations among a handful of lenders. As we pointed our earlier in the testimony, in 2011 three big bank lenders commanded a combined market share of 50 percent.

Smaller lenders were not offered the same pricing by either Fannie Mae or Freddie Mac and thus could not offer these lower prices to the consumers whose financing needs they served. Small lenders could obtain not-quite-as-favorable pricing by agreeing to sell their closed loans to one of the large lenders who enjoyed the discounted guaranty fees. The downside for small lenders was that large lenders would only purchase loans from small lenders bundled with the loan servicing rights. So, small lenders forfeited the opportunity to establish a long-term customer relationship. Small lenders also were deprived of the opportunity to build additional financial stability for their companies through the ongoing income stream from loan servicing fees.

The situation is very different today for small lenders. With the equal pricing policy mandated by Congress and implemented by FHFA, small lenders pay the same guaranty fees as large lenders. Small lenders can compete on an equal pricing basis with large lenders in the primary mortgage market with the option of selling the loan directly to Fannie Mae or Freddie Mac and retaining the servicing rights to the loan. Retaining the loan servicing rights allows small lenders to build a long-term relationship with their customers and to create greater financial stability for their company with the ongoing income from loan servicing fees.

Since the major shortcomings that led to the GSEs' conservatorship have been addressed through legislative action by Congress and administrative action by FHFA, what remains to be done? What can be accomplished administratively, by FHFA and/or other agencies or departments in the executive branch and what further action do small lenders believe Congress needs to take?

Scope of GSE Reform That Remains To Be Accomplished

There are several critical and specific actions that remain to be taken in order to complete housing finance reform. Some of these actions can be accomplished administratively and some require targeted, narrowly scoped Congressional legislation. Among the required actions are the following:

- Congress must make permanent FHFA's authority to regulate the guaranty fees charged by Fannie Mae and Freddie Mac; continue the prohibition on discriminatory or unequal pricing and extend that administrative authority and prohibition to upfront risk sharing transactions and all other actions that may foster or encourage vertical integration of the primary and secondary mortgage markets;
- Congress should make permanent the current PSPAs as an explicit Federal backstop support for the GSEs with two important changes—eliminate the capital reduction and profit sweep provisions and mandate payment of an ongoing fee by the GSEs for the backstop;
- FHFA must exercise their existing statutory authority to draw up both minimum and risk-based capital standards for Fannie Mae and Freddie Mac;
- FHFA must require Fannie Mae and Freddie Mac to draw up plans to meet both the risk-based and minimum capital standards. As mandated by HERA the GSE capital plans are then subject to approval by FHFA
- Once each GSE has an approved plan to meet the risk-based and minimum capital standards FHFA should oversee the implementation of those plans by the GSEs; and
- Once the GSEs have met the capital standards FHFA should release them from conservatorship.

Permanent FHFA Authority—Vertical Integration

For small lenders, this is the paramount issue within housing finance reform. As detailed earlier in this testimony, discriminatory pricing of guaranty fees by Fannie Mae and Freddie Mac in favor of the large lenders in the pre-crisis era led to both market distortions as well as a concentration of risk for the GSEs. The statutory prohibition of such discriminatory pricing, and the authority of the regulator to oversee and control the GSEs' guaranty fees is an essential cornerstone of housing finance reform and must be made permanent by Congress.

In addition, the extension of this prohibition to upfront risk sharing is equally essential, as is the authority for FHFA to regulate such activities. Our concern is that upfront risk sharing, while potentially an important technique for the GSEs to control their risk, also offers the same opportunities for discriminatory action favoring one group of lenders over another. So, an amendment to current law to accomplish these dual objectives is important.

Finally, we also believe that an amendment should extend the prohibition, and grant of FHFA regulatory authority, to any and all other techniques, transactions or actions by the GSEs that could provide great marketplace leverage, or lead to vertical integration of the primary and secondary markets, to any group of lenders at the expense of all other lenders. Congressional policy should be a strong endorsement and affirmation of equal pricing and equal treatment for all lenders that do business with the GSEs.

Permanent Federal Backstop

The national and international capital markets have accepted the PSPAs as proof of a Federal backstop to Fannie Mae and Freddie Mac, that has led to favorable pricing for both their debt and the mortgage-backed securities that they issue. Such favorable pricing has led directly to benefits for home buyers, who continue to enjoy an adequate supply of conventional mortgage financing at affordable rates. In addition, this market acceptance of Fannie Mae and Freddie Mac mortgage-backed securities is directly linked to the continued availability of the 30-year fixed-rate mortgage for American home buyers.

In the interests of keeping legislative action by Congress to complete housing finance reform as specific and targeted as possible, while preserving all the benefits to home buyers that flow from the current system, we believe the best course of action for Congress would be to make the PSPAs a permanent Federal backstop for the GSEs with a couple of important changes. The first would be to eliminate the capital reduction requirements currently built into the PSPAs.

As referenced above, we believe it is a reckless and ill-advised policy to run two organizations that are so vital to the smooth functioning of the U.S. mortgage market on a thin and rapidly diminishing capital level, as required by the current provisions of the PSPAs. As we have stated publicly, FHFA has the authority, as conservator, to suspend the dividend payments under the PSPAs, to allow the GSEs to build a capital buffer. Such a capital buffer is important to reduce the possibility that either of the GSEs may experience a quarterly accounting-driven loss due to their hedging activities, which in turn could require another draw under the PSPA. Such a draw could lead to market disruption or turmoil, which is entirely avoidable if the GSEs have a capital buffer, rather than a thin to nonexistent capitalization as they have now.

We would support administrative action now, or in the immediate future, by FHFA to address this situation, either through a suspension of the dividends or other means to allow the GSEs to build a capital buffer. The smooth functioning of the GSEs is too important to the housing finance needs of American consumers to allow an entirely avoidable quarterly fluctuation to disrupt their operations.

Capital Standards

Under existing law (12 U.S.C. 4611 et. seq.) the FHFA Director is authorized by Congress to establish and enforce both risk-based and minimum capital standards for Fannie Mae and Freddie Mac. Regrettably FHFA has failed to exercise this authority while the GSEs have been in conservatorship.

We believe a vital part of housing finance reform is for FHFA to immediately begin exercising its statutory authority to set both risk-based and minimum capital standards that "ensure that the enterprises operate in a safe and sound manner, maintaining sufficient capital and reserves to support the risks that arise in the operations and management of the enterprises." (12 U.S.C. 4611)

The single more important lesson from the '08 financial crisis is that capital is key. Those institutions that were well capitalized survived, those that were not, failed, or were bailed out. There will inevitably be another financial crisis at some point in the future. How it will come about, and how it will either resemble, or be starkly different, from the 2008 financial crisis is impossible to know today. But what we do know is that strong capitalization will be a decisive factor, as it has been in every financial crisis in the past 100+ years.

Capital Plans

Current law (12 U.S.C. 4622) grants the FHFA Director the authority to require a GSE that does not meet the minimum or risk-based capital standards to submit a capital restoration plan. Once FHFA has established minimum and risk-based capital standards for the GSEs, it should utilize this authority to require submission of capital restoration plans by Fannie Mae and Freddie Mac.

These plans are subject to FHFA's approval and must meet the following standards:

> "Each capital restoration plan submitted under this subchapter shall set forth a feasible plan for restoring the core capital of the regulated entity subject to the plan to an amount not less than the minimum capital level for the regulated entity and for restoring the total capital of the regulated entity to an amount not less than the risk-based capital level for the regulated entity. Each capital restoration plan shall

1. specify the level of capital the regulated entity will achieve and maintain;
2. describe the actions that the regulated entity will take to become classified as adequately capitalized;
3. establish a schedule for completing the actions set forth in the plan;
4. specify the types and levels of activities (including existing and new programs) in which the regulated entity will engage during the term of the plan; and
5. describe the actions that the regulated entity will take to comply with any mandatory and discretionary requirements imposed under this subchapter."

Release From Conservatorship

Once FHFA approves these plans the GSEs should remain in conservatorship until they have met the minimum capital standards set by FHFA. Once they have met the minimum capital standards, and any other conditions set by FHFA, the GSE should be released from conservatorship.

What Small Lenders and Their Consumers Do Not Need From Housing Finance Reform

There are a number of items that small lenders and the consumers whose housing finance needs they serve, do not need or want from any housing finance reform effort. Chief among those are the following:

- Massive, complex legislation to create someone's vision of what the U.S. housing finance system should look like if we were designing it from scratch today;
- Creating avenues or loopholes that could be exploited by the large banks and their Wall Street enablers to reestablish the un-level, concentrated mortgage market that existed in the pre-crisis era, with dominant positions for the large banks in both the primary mortgage origination and secondary capital markets;
- Examples of such avenues or loopholes would include—
  - Advocacy of incomplete or limited prohibitions on unequal pricing and risk sharing
  - Proposals to either break up Fannie Mae and Freddie Mac, remove the Common Securitization Platform (CPS) from GSE ownership, or permitting the chartering of additional GSEs
  - Permitting ownership of such "new" GSEs by large lenders, consortiums of large lenders or Wall Street investment banks; and
  - Coupling such ownership with a proposal to establish a Federal guaranty on the MBS issued by each chartered GSE.

Massive Complex Legislation

As we have stated previously in this testimony—we know the causes of the GSEs financial failures in 2008 and we know how to remedy those failures. As we have demonstrated in this testimony, such remedies do not require broad, sweeping remakes of the entire housing finance system in this country.

Such proposal for broad, sweeping remakes either from think tanks, consultants or financial trade associations representing large lender and/or Wall Street interests primarily exist for two reasons. They satisfy the ego needs of their author(s) and seek to advance the financial interests of those who funded the creation of the proposal. Neither reason is sufficient to justify the scrapping or replacement of a housing finance system that has provided affordable mortgage finance for millions of Americans and has worked reasonably well in the post-crisis era.

We know what went wrong and how to fix it. That is what we should do.

Avenues or Loopholes

As small lenders, we have noted the consistent theme of the debate over housing finance reform and the various proposals that have been put forth to address the issue. Restoration of the primary role of the large lenders has been the overriding objective of most of the players, and many of the proposals, that have been put forth.

Initially in the immediate wake of the crisis, with the GSE conservatorships in their infancy, the debate and proposals did little to cloak the primary objective of restoration of the large lender roles.

As the debate has gone on the various players have perceived that many in Congress, as well as small lender, consumer and other interest groups are either unsupportive, or actively opposed, to the restoration of the large lenders in their pre-crisis dominant roles. In recognition of this development the large lender proponents have shifted their tactics.

Their proposals now cloak their objective more carefully, but create avenues or loopholes that are designed to facilitate the efforts of the large lenders to regain their dominant role. Such avenues include a number of different items:

Limited prohibitions on unequal pricing—Various proposals seemingly embrace the current prohibition on unequal pricing and requirement of equal pricing for all lenders, but do not advocate extending that pricing to unequal risk sharing terms, or other means to favor large lenders over small lenders.

Proposals to break up the GSEs or Remove CSP—As currently constituted the GSEs are coherent, well-functioning entities that are serving the needs of the marketplace. As outlined previously in this testimony this current state of affairs can be transitioned to a post-conservatorship era with modest legislative action and appropriate regulatory action by FHFA. Breaking up the GSEs and/or removing a vital component of their ability to create a mortgage-back security to access the capital markets (the Common Securitization Platform (CSP)), serves no good purpose except to create opportunities for Wall Street and the large banks to regain their dominant positions, which they previously demonstrated they use to favor their financial interests and disadvantage small lenders and the consumers they serve.

Proposals to charter new GSEs—The U.S. housing finance system previously had hundreds of GSEs. They were called savings and loans (S&Ls) and either through direct experience, or by reading our history books, we all know how well that turned out for our country. In addition, these proposals to charter new GSEs do not contain an absolute prohibition on ownership of the newly chartered GSEs by consortiums of big banks and/or Wall Street investment banks. Thus, creating an avenue for attainment of the principal objective outlined above. The ability of small lenders to establish a mutually owned GSE is not an effective counter to this situation. The capital to establish a new GSE will be a large sum, well beyond the ability of small lenders, who constantly work to ensure the adequacy of their own capitalization, to free up cash to invest.

Proposals to federally guarantee GSE–MBS—On the surface proposals to establish a Federal guarantee for MBS issued by the GSEs appear worth considering. With an explicit Federal guarantee investors could feel secure that principal and interest on their MBS would be paid no matter what turmoil engulfs the marketplace. However, a closer examination of the issue reveals several troubling facets:

- Securities carrying the full faith and credit guarantee of the U.S. Government would permit banks, particularly large banks, to own such securities without holding any capital against them. The capital free nature of such securities would give large banks an advantage not enjoyed by other investors, which in turn could lead to ownership concentrations, that in turn could grant undue leverage and influence to the large banks.
- If this capital-free securities status for large banks were coupled with the ability of large bank consortiums to establish and own a GSE, you could easily see how this would facilitating the reestablishment of the dominant role for large banks in the mortgage marketplace and extend that dominant role to the secondary market as well
- Currently the only mortgage security that has a full faith and credit Federal guaranty is the Ginnie Mae mortgage-backed security, which is the financing vehicle for FHA-insured, VA-guaranteed and Rural Housing loans. Each of these loan programs serves groups for whom the lower interest rates afforded by the Federal guaranty is critical: first time buyers, low and moderate income buyers, veterans, and rural borrowers. What impact will there be on the GNMA program and the borrowers it serves, if GSE MBS received the same guaranty? We believe this issue merits further exploration and discussion, at the very least.

Conclusion

We would ask members of the Senate Banking Committee to note the contrasts between the testimony you are hearing today, from groups whose membership consists solely of small lenders, and previous testimony from groups whose membership includes large lenders.

Hopefully you have noted the consistent message from small lenders, simply asking Congress for limited action sufficient to address the well-known reasons why the GSEs entered conservatorship. Further that Congress should take legislative action that contains specific provisions to address those issues, without upending the current mortgage market. We would ask the Committee to remember that the organizations that have testified before you today do not need to take into account, or negotiate the views they have expressed to you today with the large lenders, many of whom were responsible for much of what led to the 2008 financial crisis. Our views are the distillation of the observations and beliefs of our members, small lenders all, who have faithfully served the mortgage finance needs of their communities through thick and thin and were not responsible for the actions and conditions that led to the 2008 financial crisis.

Thank you for this opportunity to present out testimony. Please contact us with any questions and if you desire additional detail.

PREPARED STATEMENT OF WILLIAM GIAMBRONE

PRESIDENT AND CHIEF EXECUTIVE OFFICER, PLATINUM HOME MORTGAGE, ROLLING MEADOWS, ILLINOIS, AND PRESIDENT, COMMUNITY HOME LENDERS ASSOCIATION

JULY 20, 2017

Testimony of William Giambrone

Chairman Crapo, Ranking Member Brown, and Members of the Committee, I appreciate this opportunity to testify before you today. I am the President of Platinum Home Mortgage, an independent mortgage banker, based in Rolling Meadows, a suburb of Chicago, Illinois. I appear before you today as President of the Community Home Lenders Association (CHLA).

The Community Home Lenders Association is the only national association that exclusively represents non-bank mortgage bankers.

CHLA members are all small businesses, with single family mortgage lending and servicing as their sole or principal business line. Our Members are community-based, generally serving either local or regional markets.

CHLA Members are all independent mortgage bankers (IMBs). IMBs are non-banks that originate and service mortgage loans. Unlike banks and other depository institutions, IMBs do not put taxpayers at risk through an underlying FDIC or NCUA guarantee.

CHLA members are all small- and mid-sized IMBs. These types of lenders are not – either singly or collectively - large enough to pose systemic risk to the financial system.

For all these reasons, CHLA is uniquely qualified to advocate for GSE policies that protect the interests of small mortgage lenders in general and IMBs in particular – in order to advocate for policies that promote consumer access to mortgage credit through community-based IMBs.

Why Small, Community-Based IMBs Are Important

In the aftermath of the 2008 housing crisis, many banks dramatically scaled back mortgage lending. For example, Bank of America terminated their correspondent lending business for smaller mortgage lenders. And many banks imposed credit overlays, even for FHA-insured loans, limiting mortgage loans to only the highest credit quality borrowers.

In the face of this mortgage credit vacuum, it was IMBs that stepped in to increase mortgage lending, particularly for first-time and low/middle income homebuyers. The reason for this is simple. **Mortgage lending is all that IMBs do. Unlike banks that reduce or restrict mortgage lending when it does not meet their Return on Investment targets, IMBs keep lending.**

Neither Fannie Mae nor Freddie Mac (or their regulator, the Federal Housing Finance Agency [FHFA]) keep data on non-bank market share of Fannie and Freddie loan originations. However, we believe that IMBs (and smaller IMBs in particular) have stepped up their share of GSE mortgage loan origination as banks decreased theirs.

In the one area where we do have data - FHA - we know this has been the case. Historically, IMBs have consistently averaged over 50% of the FHA loan origination market. **However, since the 2008 housing crisis, non-bank market share of FHA loan originations has increased - from 57% in 2010 to 85% in 2016. And, IMB non-bank market share of Ginnie Mae issuance also increased in that same period – from 12% in 2010 to 73% in 2016.** [A link to this data is provided at http://communitylender.org/chla-releases-data-showing-non-bank-dominance-in-fha-loan-origination-is-not-new-5417/]

This data shows that IMBs stepped in to fill the mortgage access to credit vacuum created when the large banks severely limited their lending and it also shows that many IMBs began using GNMA to securitize FHA loans as banks left the correspondent business. Our experience is that there are similar patterns with GSE lending, aided in part by the GSEs providing secondary market access to small IMBs through their cash window, as some banks no longer served as aggregators.

The implications for GSE reform are clear: Small mortgage lender access to the secondary GSE market is critically important, because IMBs have a long history of consistently providing affordable mortgage loans, particularly to low and moderate income borrowers, in all economic and housing cycles.

The Role of Congress in GSE Reform

There seems to be a consensus that we cannot return to the pre-2008 model of "private gain, public loss" with regard to the GSEs and federal housing policy. CHLA agrees with this position.

Many GSE reform plans include a recapitalization of Fannie Mae and Freddie Mac and their ultimate exit from conservatorship. Opinions on how this should be done range from a belief that there is sufficient authority under the 2008 Housing and Economic Recovery Act (HERA) to accomplish this administratively to a belief that recapitalization should not take place without comprehensive Congressional reform legislation. CHLA's position is that it is far preferable to have Congress pass a sound bill to make permanent changes – but that reforms can (and should) continue while Congress debates the issues.

CHLA believes FHFA should establish a $10 billion capital buffer for each GSE (the amount in the original Treasury Department's reserve plan, which was later rejected in favor of a mandated draw down to zero capital at year-end) and that FHFA should develop a Capital Restoration Plan to show how the GSEs could be recapitalized and exit conservatorship. This analysis will be helpful regardless of the direction Congress ultimately takes with respect to GSE reform.

Our CHLA GSE Reform Plan explicitly calls for Congress to act on GSE reform legislation that includes specific provisions to protect small mortgage lenders.

Finally, the CHLA Plan calls for Congressional action to continue or where necessary codify the **significant number of reforms that protect taxpayers have already been put in place**, which include:

1. **End to GSE No-Doc Mortgage Loans.** A major factor in the GSEs' conservatorship was the purchase of no doc (Alt A) loans, in part in response to similar loans made by subprime lenders. Congress since adopted the Qualified Mortgage (QM) law establishing Ability to Repay standards, and Fannie or Freddie no longer make no-doc loans.

2. **Credit Risk Sharing.** The GSEs have been doing risk sharing on over 90% of new loans, and to date have transferred $50 billion in credit risk to third party private entities.

3. **Portfolio Wind Downs.** The significant interest rate risk that the GSEs were exposed to before 2008 has largely been eliminated with a major winding down of their portfolios.

4. **Strong Regulator.** The 2008 HERA legislation replaced a weak regulator (the Office of Federal Housing Enterprise Oversight or OFHEO) with a strong regulator (FHFA) that has focused on effective, proactive regulation.

5. **Taxpayer Compensation for Federal Guarantee.** The pre-2008 deal in which GSEs had an implicit guarantee without compensating fees has been replaced by a full profit sweep under the Preferred Stock Purchase Agreement (PSPA) (also known as the "Sweep Agreement") – and an expectation of fair guarantee fees under GSE reform.

6. **Common Securitization Platform (CSP)/Common Security.** FHFA, Fannie Mae and Freddie Mac continue their work on a CSP and single security - to create a more uniform, competitive securitization process.

Objectives of GSE Reform

CHLA believes that the key to effective GSE reform effort is to preserve and codify a housing finance system that facilitates full access for all qualified small mortgage lenders on a fully competitive pricing basis, and that this can be done while protecting taxpayers and without growing the federal government.

This principle of full and fair access to the housing finance system is also best for consumers. Recently, CHLA joined three major affordable housing/consumer groups (the NAACP, the Leadership Council on Civil and Human Rights, and NCRC) along with two other small lender groups (CMLA and the Leading Builders of America) to publicly release the Main Street GSE Reform Coalition **"COMMON GSE REFORM PRINCIPLES"**.

This document identifies a simple objective that the groups believe should govern GSE reform: ***"The primary objective of any GSE reform legislation should be to promote broad access to affordable, sustainable mortgage credit in all communities while minimizing risk to taxpayers."***

This "Common GSE Reform Principles" document lays out principles that Congress should adhere to in adopting GSE reform legislation. We appreciate that the Committee entered this document into the record at its recent GSE hearing. We urge Committee Members to review it.

CHLA GSE Reform Plan. In July 2015, CHLA released a plan for GSE reform, and re-released our plan in March of this year, to reflect developments over the last two years. **The CHLA Plan is enclosed as an Appendix,** and will be explained in this testimony. We encourage Committee Members to read our Plan.

Immediate Actions Are Needed

CHLA appreciates the Committee's commitment to adopting comprehensive GSE reform legislation. However, regardless of whether or how soon this is done, we believe there are two very important actions that should be taken immediately that do not require Congressional action.

First, the FHFA – preferably with the support of the Treasury Department- should use its authority under the 2008 HERA to suspend GSE dividend payments to the Treasury, allowing Fannie and Freddie to build a $10 billion capital buffer.

Some have argued that a Treasury Advance would be fine, that it would have no impact or even could have a positive impact by prompting Congress to act on GSE reform. However, this perspective is contradicted by the GSEs' financial regulator, FHFA Director Mel Watt, who has referred to the GSEs' lack of capital as ***"the most serious risk"*** facing these entities - noting both a potential negative impact on MBS investors and an adverse Congressional reaction to a Treasury Advance.

It is also important to distinguish between a modest capital buffer and full recapitalization of Fannie and Freddie. The temporary suspension of dividends to build a $10 billion capital buffer is of a completely different magnitude from the amount of capital needed to recapitalize the GSEs. Moreover, the establishment of a modest capital buffer does not commit the GSEs to a full recapitalization and does not move it close to release from conservatorship. It is just sound policy, reflecting the main lesson we learned from the 2008 crisis - that it makes no sense for entities to engage in credit and other financial risks without the necessary capital to offset credit or accounting losses.

Secondly, CHLA believes the FHFA, as the GSEs' conservator and under its authority in HERA, should develop a capital restoration plan to show how the GSEs could emerge from conservatorship.

CHLA believes the best approach for GSE reform is to preserve and recapitalize Fannie and Freddie pursuant to a Utility Model, with taxpayers protected through capital to absorb losses, risk sharing to reduce direct GSE risk, strong underwriting of loans and counterparty risk, and fees to compensate for the federal backstop. Many other plans propose to recapitalize the GSEs in a similar manner. Regardless of what Congress, the FHFA, and the Administration ultimately decide to do with Fannie Mae and Freddie Mac, Congress and other federal policy makers would benefit from understanding how GSE recapitalization could be implemented as well as the cost in both dollars and continuing oversight staff.

Both of these recommended actions are included in CHLA's GSE Reform Plan.

How Mortgage Lenders Access the GSE Secondary Market

The key to understanding small mortgage lender concerns about changes to our housing finance system is to understand how the system currently works, particularly with regard to GSE loans.

The process of mortgage lenders originating mortgage loans constitutes the "**primary market.**" Mortgage lenders – ranging from the tiniest community bank or IMB to the largest megabank – underwrite and close new mortgage loans in conformity with underwriting standards established by Fannie Mae and Freddie Mac. These two GSEs approve qualified seller/servicers, who are then eligible to originate and sell qualified loans to Fannie and Freddie.

Since the 2008 housing crisis, Fannie and Freddie have significantly reduced their mortgage loan portfolios with the great majority of loans sold and pooled into Mortgage Backed Securities (MBS) that are guaranteed by Fannie and Freddie. The activity of liquefying these mortgage loans is referred to as the "**secondary market.**"

Originated loans find their way into the secondary market in two ways. The first is the **cash window.** Through the cash window, mortgage lenders sell loans or pools of loans directly to Fannie Mae or Freddie Mac.

The second option for execution into the secondary market is **securitization of loans.** Mortgage lenders pool a group of loans qualified for the Fannie or Freddie guarantee and sell those loans into the secondary market through a securities broker/dealer. This can either be done directly by the originating mortgage lender or can be done by selling to an aggregator that buys different pools of loans and aggregates and securitizes such loans.

Generally, smaller mortgage lenders or lenders with smaller loan volume tend to use the cash window, while larger mortgage lenders use the securitization option. However, mortgage lenders that securitize loans sometimes use the cash window option, particularly when the price is competitive with or better than doing securitization.

Key Provisions Needed to Protect Small Mortgage Lenders

The key to understanding small mortgage lender concerns regarding how GSE reform is done revolves around the relationship between the primary and secondary markets.

The unifying theme behind these concerns is that secondary market players – particularly vertically integrated investment banks or banks - might be able to use their market clout as a secondary market force to monopolize or dominate the primary loan origination market, acting through their bank affiliates that originate mortgage loans.

Such a development could: (1) harm small mortgage lenders by reducing their access to the GSE secondary market, (2) harm consumers by reducing competition, (3) increase financial concentration, and (4) concentrate the GSE mortgage market in the hands of the very institutions that developed the subprime mortgage market and funded that market through their MBS infrastructure in the period leading up to 2008.

There are related concerns regarding the development of risk sharing – either that risk sharing providers could use risk sharing to gain control or dominate the mortgage market, or that they might engage in volume discounts or other more favorable pricing treatment for certain mortgage lenders based solely on the size of the lender or their loan volume.

In light of these two forms of secondary market execution, there are two key objectives:

1. **It is essential that a cash window exist which is fully capable of meeting ALL the demand for origination and sale of GSE loans under fully competitive prices, terms, and conditions, and**

2. **It is essential that the securitization execution option is preserved – also under competitive prices, terms and conditions - for all participants.**

CASH WINDOW. Under the GSE reform bill that passed the Senate Banking Committee last Congress, Fannie and Freddie were ultimately eliminated, and the infrastructure needed for continuation of a cash window were spun off into a mutual cooperative. While that legislation did provide for the transfer of needed infrastructure to the co-op to try to maintain this function, there was not a viable plan to capitalize the mutual cooperative. The bill referenced using GSE profits to do so – but it is doubtful that would be sufficient, and in practice, the Sweep Agreement has meant that no profits are being accumulated for that potential purpose.

It is for these reasons that small mortgage lenders generally support the recapitalization and preservation of Fannie Mae and Freddie Mac, which have historically carried out the cash window function. It is also why many groups support the concept of a Utility Model. This would make it more likely that Fannie Mae and Freddie Mac would focus on their primary mission of facilitating access to the secondary market with a level playing field.

Finally, the need to have a fully competitive cash window is a major reason why many groups like CHLA oppose chartering new entities to compete with Fannie and Freddie, particularly if such new entities have secondary market capabilities such as the Wall Street Banks.

SECURITIZATION EXECUTION. Most of the small mortgage lender groups tend to focus on the cash window and CHLA has made this a priority. However, **CHLA has also been a leader in emphasizing the importance of preserving full and competitive access to securitization execution to create a broadly competitive market.**

It is our Members' experience that the securitization option is important to help ensure that Fannie and Freddie offer fully competitive cash window pricing and execution. Thus, maintaining a strong, vibrant securitization execution option is not just important to lenders that securitize loans; it is also critically important for small mortgage lenders that use the cash window, and for consumers who benefit through increased competition in pricing and customer service.

SMALL MORTGAGE LENDER PROTECTIONS:

For all these reasons, CHLA strongly recommends that any GSE reform legislation include the following key features or provisions which are designed to protect small mortgage lenders:

1. Preservation and Recapitalization of Fannie Mae and Freddie Mac, using a Utility Model.

Fannie and Freddie need to be preserved and recapitalized to ensure they can continue to play their historic role in facilitating small lender access to the secondary market for GSE-type loans or MBS that are backed by the federal government. A Utility Model helps ensure their focus on this role and their long-term sustainability.

2. No new charters should be authorized to carry out functions that Fannie Mae and Freddie Mac carry out.

GSE reform legislation should not charter <u>any</u> new entities to compete with the GSEs, particularly ones that could have any role in the primary mortgage loan origination market.

First, CHLA believes that it is a mistake to create new Too-Big-To-Fail (TBTF) institutions, particularly entities affiliated with FDIC-insured institutions. The likely impact of authorizing new charters would be to grow the government, to increase the risk of a taxpayer bailout like we experienced with TARP, and to expand the scope and burden of the regulator(s) with respect to monitoring both their financial safety and soundness and their conduct in the mortgage market.

The risk of increased financial concentration of chartering new TBTF entities is great. In a May 12th speech by FDIC Vice Chairman Thomas Hoenig, he noted that while the four largest U.S. banking firms in 1992 held roughly 14% of total industry assets, they now hold 42% of such assets – with $7 trillion in assets, roughly 38% of the U.S. gross domestic product. And, the 20 largest banks hold more than 60% of industry assets. Mr. Hoenig went on to note that the current size of these institutions has transformed banking in the U.S. and that these institutions dominate the industry and increasingly dominate our economy.

While we appreciate the desire to bring in more private capital into the GSE process, we believe this can be better accomplished through risk sharing, dispersed among a large diverse source of investors, than by giving large banks, investment firms, or insurance companies a major new role in government-backed mortgages and a significant new financial risk related to that role.

Secondly, chartering Wall Street investment banks to compete against Fannie and Freddie could invite the same types of practices that we saw in the subprime crisis, with a race to the bottom on credit quality followed by taxpayer bailouts of these TBTF institutions during a crisis. The lesson we learned from that crisis is that when the TBTF institutions go too far and need a bailout, small lenders also suffer the consequences, from heightened regulations.

Third, the Senate Banking Committee had grave concerns about vertical integration in their previous GSE reform legislative effort. We urge the Committee not to open the door to new GSE charters for as there is no way to ensure that such new charters will not be influenced or controlled a large bank or investment bank with even a modest ownership interest or that had a major role in funding or creating the new charter entity.

Finally, the creation of new charters designed to have the entities compete on things like pricing seems somewhat inconsistent with the concept of a Utility Model, and seems to take the GSEs beyond the role of simply facilitating secondary market mortgage access.

3. All risk sharing should be done as back-end risk sharing.

To date, Fannie and Freddie have carried out the majority of their risk sharing on a back-end basis after GSE purchase of the qualified loan. This practice creates a broad competitive investment market for the risk sharing – and does not negatively affect small mortgage lender access. In contrast, up-front risk sharing could create significant risks for small lender access – as it could result in the risk sharing providers, particularly vertically integrated Wall Street Banks, engaging in anti-competitive practices, such as exclusively dealing with their bank lending affiliate or engaging in the practice of volume discounts.

Moreover, if up-front risk sharing becomes either an exclusive or dominant practice, it would create a chokepoint, where small lenders can't sell to the GSEs without delivering risk sharing at the same time. This threatens small mortgage lender access to the secondary market.

Finally, up-front risk sharing is much more likely to result in the re-aggregation of risk that could result from a small group of institutions or investors doing risk sharing on the front end.

The simplest and most effective way to address this concern is to allow risk sharing only on the back-end - after loans have been delivered to the GSEs.

However, if Congress elects to permit risk sharing on an up-front basis, it should not be allowed to be provided by any entity with a stake in primary loan origination, for the reasons cited above, and should only be allowed by private mortgage insurers (PMIs) or other entities with no ties to primary loan origination. Further, if allowed, protections should be in place to protect small mortgage lenders – including a ban on volume discounts, a requirement that a PMI serve all qualified seller-servicers, and fully transparent pricing.

4. Pricing, underwriting and variance parity.

The FHFA has substantially ended the anti-competitive, discriminatory practices of the GSEs prior to conservatorship. GSE legislation should codify a prohibition of any differential treatment based on lender volume or size with respect to pricing, underwriting or variances by the GSEs in the future. With respect to pricing, this should include G-fees, buy-up or buy-down grids, loan level price adjustments, credit risk transfers or any proxy for these. The GSE legislation should also prohibit special underwriting deals and variances which put certain lenders at a competitive disadvantage and create unnecessary risk for the GSE's. The legislation should require the GSE's to become completely transparent and publish all seller/servicers G-fees and related information. Finally, the legislation should require proper due process for all small and mid-sized lenders, so that there is no discrimination based on charter or lender size or volume in areas such as reps and warrants.

Other GSE Reform Issues Included in the CHLA Reform Plan

CHLA also supports the following provisions in GSE reform:

- **Continued government backstop of qualified MBS.** Whether in the form of an explicit guarantee, substantial federal line of credit, or some other form or guarantee, this is needed to generate broad access to national and international investors in MBS. This should be combined with charging reasonable G-Fees to cover the projected risk of the government backstop in the form of an Insurance Fund that builds up. Combined, this would reform the old "private gain, public loss" approach that characterized the implicit guarantee in place prior to 2008.

- **Prohibit selling off the Common Securitization Platform (CSP) so that Wall Street Banks cannot control it**. The regulatory reform legislation that passed the Senate Banking Committee two years ago included a provision to turn over the CSP to a private entity (which would likely be controlled by the large Wall Street banks). CHLA is strongly opposed to any such provision, as it could have the effect of turning over the GSE secondary market infrastructure to the large private secondary market participants. For the types of reasons outlined in the previous two sections, this would be detrimental to small mortgage lender access to the secondary market.

- **Access to credit requirements – servicing all qualified borrowers, all geographic areas, etc.** CHLA is aware that the details of how this would be accomplished are complicated. However, as a general principle, participants in the GSE loan process utilizing a government guarantee or whatever government support is ultimately provided should not be able to cherry pick loans by serving only the higher credit quality borrowers. Moreover, the overall system should serve all geographic areas, and more generally facilitate affordable housing.

Appendix - CHLA GSE REFORM PLAN

[March 29, 2017]

MAJOR CHLA OBJECTIVES FOR GSE REFORM

- ***Preserve 30-year affordable mortgage, with broad consumer access to mortgage credit.*** A federal guarantee of qualified mortgage backed securities (MBS) is needed to access sufficient investors to ensure affordable mortgages for all qualified borrowers, with provisions to ensure a federal guarantee is not just used to serve high FICO borrowers.

- ***Full & Competitive Small Lender Access to Cash Window & Securitization Execution.*** Fannie Mae and Freddie Mac should be preserved to avoid market concentration by Wall Street banks, and facilitate broad lender access with full G Fee/risk-based pricing parity.

- ***Protection of Taxpayers.*** Essential elements include: (a) private GSE capital to absorb losses, (b) risk-sharing, (c) strong FHFA regulation, & (d) strong underwriting standards.

- ***Minimize Transition Risk.*** Reform should have a smooth transition and be based on a practical workable plan, to avoid disruptions to the housing market and broader economy.

SIGNIFICANT REFORMS HAVE ALREADY TAKEN PLACE SINCE 2008

There is a consensus not to go back to the pre-2008 model of GSE "private gain, public loss." But claims that recapitalization of Fannie and Freddie means going back to the old failed model are largely a straw man argument. While private capital is still needed to complete the process, significant reforms (with bi-partisan support) have already taken place and are irreversible:

1. **Ability to Repay (QM).** A major factor in the GSEs' conservatorship was their purchase of no doc (Alt A) loans. With adoption of QM, no doc loans are a thing of the past.

2. **Credit Risk Sharing.** The GSEs have been doing risk sharing on over 90% of new loans, and to date have transferred $49 billion in credit risk to third party private entities.

3. **Portfolio Wind Downs.** The significant interest rate risk that the GSEs were exposed to before 2008 has largely been eliminated with a major winding down of their portfolios.

4. **Strong Regulator.** The 2008 HERA legislation replaced a weak regulator (OFHEO) with a strong regulator (FHFA) that has focused on effective, proactive regulation.

5. **Taxpayer Compensation for Federal Guarantee.** The pre-2008 deal in which GSEs had an implicit guarantee without compensating fees has been replaced by a full profit sweep under the PSPA – and an expectation of fair guarantee fees under GSE reform.

6. **Common Securitization Platform (CSP)/Common Security.** FHFA is engineering a CSP and single security - to create a more uniform, competitive securitization process.

CONTINUE REFORMS & RECAPITALIZE UNDER A UTILITY MODEL

While Congress must continue to play a strong oversight and advisory role, comprehensive legislation is not needed at this time. This CHLA GSE Reform Plan would recapitalize and re-privatize Fannie and Freddie using a Utility Model under a plan to be developed by FHFA as conservator, and then agreed to by the Treasury Department and Congress. Taxpayers would be protected by private GSE capital, risk sharing, strong FHFA regulation, and sound underwriting. Other provisions in the Plan protect small lender access and consumer access to mortgage credit.

CHLA Implementation Plan for GSE Reform

1. FHFA Should Immediately Suspend Fannie, Freddie Dividends, to Build a Capital Buffer up to a .5% capital level – in order to Avoid a contrived Treasury Advance under the existing Sweep Agreement.

FHFA Director Watt has identified the GSEs' declining capital buffer under the Sweep Agreement as their "most serious risk," warning that a resulting Treasury advance carries investor and political risks. The GSEs' Net Worth is not declining because they are losing money - they have been routinely profitable and have paid back tens of billions of dollars to Treasury above and beyond their 2008 advance. Rather, the GSEs' Net Worth has been declining because the Sweep Agreement sweeps quarterly profits and arbitrarily reduces their Net Worth to zero on January 1, 2018. FHFA, with the support of Treasury, should suspend dividends as long as is necessary to build a capital buffer to cover short term losses.

2. FHFA Should Develop a Capital Restoration Plan for Fannie Mae and Freddie Mac – under which they are re-privatized pursuant to a Utility Model and ultimately taken out of Conservatorship

FHFA, as conservator, is the appropriate entity to develop a Capital Restoration Plan for the GSEs – with Congress playing an advisory and oversight role in that process.

Further, **CHLA believes that the best approach is a Utility Model**, in which the GSEs build up capital to enable them to exit the conservatorship and re-emerge as private entities, in which they perform a mortgage securitization and standardization role, supported by a government backstop of their MBS. Taxpayers are protected by private GSE capital; third-party credit risk transfers to absorb losses; robust FHFA regulation of underwriting standards and counter-party risk; fees to cover the risk of the backstop.

[Note: though not in CHLA's area, the GSEs' role should also include multifamily loan purchases}

3. After FHFA Submission of a Capital Restoration Plan, FHFA and Treasury Should Agree on a Plan.

After FHFA development of a Plan, FHFA and Treasury should then work together to reach agreement on a Capital Restoration Plan – with a goal of either the informal support of Congress or their formal approval by legislation. This should then trigger an amendment of the PSPA – to allow the accumulation of GSE capital, along with modifications of common and preferred stock positions, as follows:

- GSEs should retain & accumulate their profits, to help them meet the Plan's capital requirements.
- The debt under the federal government's Senior Preferred stock holding should be deemed extinguished, since the GSEs have paid back 140% of their original advance – and the warrants should be converted or disposed of consistent with the agreed-upon Capital Restoration Plan.
- Existing common and junior preferred stock holders' interests should be eliminated or otherwise reduced as appropriate, consistent with the agreed-upon Capital Restoration Plan.
- Fees should be assessed on MBS to reflect the risk of the taxpayer federal guarantee, consistent with the agreed-upon Capital Restoration Plan and their impact on recapitalization efforts.
- Except and unless modified by Congress, existing HERA statutory Housing Trust Fund and Capital Magnet Fund contributions, housing goals, and Duty to Serve provisions shall continue during implementation of Capital Restoration Plan

4. GSEs Should Continue Back-End Credit Risk Transfer (Risk Sharing), and only allow Up-Front Risk Sharing with PMIs on a loan level basis with small lender protections (eg., prohibition on volume discounts).

Up-front risk sharing using a securitization structure could lead to increased market concentration among large lenders, which is bad for consumers. The biggest concern is that this would invite the types of vertical integration abuses that Congress has long been concerned about – where a number of large Wall Street Banks have the size and securities expertise to carry out up-front securitization risk sharing structures and then exclusively use the loan proceeds to originate loans through their bank affiliates. More broadly, up-front risk sharing with a securitization structure creates a choke point – GSE seller-servicers cannot sell loans to the GSEs without third party risk sharing in place.

Up-front risk sharing could be acceptable if done on a loan level basis with PMIs (which don't compete in the loan origination business) – except that there should be formal protections to ensure competitive small lender access - specifically: (1) prohibitions on volume discounts, (2) offering PMI to all eligible seller-servicers, and (3) transparent, publicly available pricing.

5. FHFA should complete work on a Common Securitization Platform (CSP) and Single Security – and should not turn over the CSP to the Too-Big-To-Fail Wall Street Banks (or a new entity that they control).

Completion of the CSP helps to create a more uniform, competitive securitization process, with the single security avoiding pricing discrepancies between the two GSEs that could result in distortions. Additionally, CHLA believes that, since the CSP was effectively developed with taxpayer dollars, it should not be turned over to a non-profit or other new entity, which is likely controlled by the large Wall Street Banks. Instead, the CSP should continue to be used to exclusively facilitate GSE securitizations.

6. FHFA and the GSEs should continue progress towards full G Fee Parity and full transparency in pricing, in order to ensure broad loan origination access to small and mid-sized lenders.

The pre-2008 practice of volume discounts, for lenders like Countrywide, encouraged industry concentration and distortive behavior. FHFA and the GSEs should continue the significant progress they have made since then in moving towards G Fee pricing parity – by extending this treatment to include not just the Cash Window, but also buy-up/buy-down grids. Such a requirement for equitable pricing should be incorporated into FHFA regulations, and into Congressional legislation. Formulation of these policies would be enhanced by maximal transparency in both pricing and seller-servicer eligibility qualifications.

7. Congress Should Ultimately Enact Legislation to adopt provisions that only Congress can do, eg., providing an explicit federal guarantee.

Ultimately, Congress will need to enact legislation to accomplish certain things that can only be done through legislation – as well as to codify key policies that have been developed administratively – ie:

- Provide an explicit guarantee, along with a requirement to charge fees commensurate with the risk of that guarantee.

- Codify provisions like strong regulation, capital levels, risk sharing, & small lender protections - but flexibly (not in an overly prescriptive manner) to allow for changing market conditions.

- Appropriate Access to Credit requirements, including Housing Trust Fund/Capital Magnet Fund contributions, and Duty to Serve/ housing goal provisions to ensure that the federal guarantee is not used to serve only the highest quality credit borrowers – but is instead used to serve a broad range of qualified borrowers, geographic areas, and appropriate product types.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR COTTON FROM BRENDA HUGHES

Q.1. *On Extending the Safe-Harbor for Qualified Mortgages to Portfolio Loans*—A Qualified Mortgage (QM) is a designation created by the Dodd–Frank Act and is reserved for loans that meet certain requirements: i.e. if the lender obtained the required paperwork from the borrower and the borrower has thus demonstrated an "ability to repay." Loans that meet the Qualified Mortgage standard are given a legal safe harbor from litigation regarding the borrower's true ability to repay.

A key reason for the QM standards was to give those who bought these mortgages on the secondary market some assurance that borrower's ability to pay was properly assessed.

But the loans that lenders keep in their own portfolio—that they don't sell to anyone—don't have this safe-harbor protection afforded to them.

Do you support expanding the definition of Qualified Mortgage to include all loans held in portfolio? Please explain your reasoning.

A.1. Yes. Specifically, as it relates to First Federal, we approve loans where we feel we have appropriately underwritten the borrower's ability to repay. This underwriting standard is not new to First Federal and is applied whether we originate a loan to be held on our books or sold in the secondary market. Additionally, if I were to look at a broader application, I cannot see where there would be a benefit to a financial institution to put a loan on their books where they do not have confidence in the borrower's ability to repay Portfolio lending is among the most traditional and lowest-risk lending in which a bank can engage. Loans held in a bank's portfolio are well underwritten because if a loan is to be held in the portfolio, the bank carries all of the credit and interest rate risk of that loan until it is repaid. Therefore, it must be sufficiently conservative to protect the safety and soundness of the bank. However, existing QM mortgage rules are too restrictive and have made it difficult, and in some cases impossible, for creditworthy borrowers—especially low-income families—to obtain safe and sound loans from portfolio lenders. I urge you to support legislation that, would treat any loan made by an insured depository and held in that lender's portfolio as compliant with the Ability to Repay and Qualified Mortgage requirements and would provide an important and much needed correction to the unnecessarily restrictive standards that now exist.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR COTTON FROM JACK E. HOPKINS

Q.1. *On 18-Month Exam Cycle*—Currently credit unions and community banks with assets of less than $1 billion in assets can earn the right to move to an 18-month exam cycle instead of being examined every 12 months. They earn this only when regulators give them stellar results on their annual exams.

To those of us who approve of this policy, the appeal of this incentive is 3-fold:

- Lenders that have earned the 18-month exam cycle want to keep it and are thus incented to stay in excellent shape.
- Lenders that are currently on a 12-month exam cycle have an additional incentive to improve their performance.
- Regulators can focus on the lenders that do in fact have significant problems.

What are the tangible benefits, both to customers and to the lender, when a lender moves to the 18-month exam cycle.

A.1. First, ICBA fully agrees with you that the 18-month exam cycle for well-rated banks creates positive incentives for performance that make the banking system safer and allows regulators to focus on the banks that pose the greatest risk. We appreciate your support for this policy.

I would add to this that too frequent or intrusive exams create a significant distraction for community bankers that prevents them from serving their customers to their full potential. The examination process is lengthy and its repetition at too-frequent intervals leaves little time when a bank is free of examiners and management can give their full attention to its customers. Ultimately, the customer is adversely impacted.

Q.2. Should we extend this incentive to more lenders, for example by raising the asset threshold so that lenders with $2bn, $5bn, or perhaps $10bn of assets can earn 18-month exam cycles via stellar exam performance?

A.2. Following on the rationale set forth above regarding the positive performance incentives created by a longer exam cycle, ICBA advocates both a higher asset threshold and a longer exam cycle. ICBA's Plan for Prosperity recommends a 2-year exam cycle for well-rated banks with up to $5 billion in assets. A higher asset threshold would reflect recent and ongoing industry consolidation which has raised the average asset size of community banks. A longer exam cycle would strengthen performance incentives, better target exam resources, and allow bank management to better focus on their communities. A longer exam cycle for well-rated banks could be safely implemented because examiners would continue to monitor bank performance through quarterly call reports.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR COTTON FROM CHUCK PURVIS

Q.1. *On 18-Month Exam Cycle*—Currently credit unions and community banks with assets of less than $1 billion in assets can earn the right to move to an 18-month exam cycle instead of being examined every 12 months. They earn this only when regulators give them stellar results on their annual exams.

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• Regulators can focus on the lenders that do in fact have significant problems.

What are the tangible benefits, both to customers and to the lender, when a lender moves to the 18-month exam cycle?

A.1. An 18-month exam cycle would lower our exam preparation and support costs by one-third. We estimate our internal costs of preparing materials in advance and responding to examiner inquiries during the 2–3 week exam to be approximately $200,000. Many internal projects are suspended for 2–4 weeks during each exam cycle.

These savings would be available to improve rates and lower fees for our members, or to enhance services used by members.

Q.2. Should we extend this incentive to more lenders, for example by raising the asset threshold so that lenders with $2bn, $5bn, or perhaps $10bn of assets can earn 18-month exam cycles via stellar exam performance?

A.2. Yes. NAFCU believes that all well-run credit unions should have access to an 18-month exam cycle. As a credit union, we provide an extensive set of management, financial, operational and risk reports to our Board every month. These are available online for our examiner to review each month. NCUA should look at ways of reducing examiner time in credit unions. This can be done be reviewing these financials remotely, or collecting more data remotely during this 18-month period. This could allow NCUA to follow what is going on at the credit union, while not adding the burden of more frequent examiner visits.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

LETTER SUBMITTED BY CAPITAL MARKETS COOPERATIVE

CAPITAL MARKETS COOPERATIVE
a Computershare company

July 18, 2017

The Honorable Mike Crapo
Chairman
U.S. Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
U.S. Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown,

As the Senate Banking Committee continues to explore options to reform Fannie Mae and Freddie Mac (the GSEs), we are encouraged by the recognition of the benefits that are provided by smaller mortgage lenders.

I am writing to you on behalf of the Capital Markets Cooperative ("CMC"). CMC supplies products, services, and capital to small and mid-sized residential mortgage lenders, and is a significant player in the U.S. residential mortgage industry. The 421 lenders with which CMC works today comprise a large portion of the residential mortgage industry:

- They originate residential mortgage loans in nearly every town and city in the U.S.
- They collectively originate over $100 billion of residential mortgages each year, or approximately 10% of our nation's annual mortgage origination volume.

Our lenders increase the diversity of mortgage products available to consumers, leading to a more vibrant and well-functioning market. We are also able to serve segments of the market that may be ignored by other types of lenders, which helps to ensure the widespread availability of mortgages for creditworthy borrowers throughout the country.

Of note, CMC was recently acquired by Computershare, Inc., a large multi-national firm that is a relatively new entrant to the U.S. residential mortgage industry. Opportunities in the U.S. mortgage industry have caught Computershare's attention. It is investing hundreds of millions of dollars in the residential mortgage industry, via small and mid-sized lenders.

814 A1A North, Suite 303
Ponte Vedra Beach, FL 32082
phone 904.543.0052
www.capmkts.org

CAPITAL MARKETS COOPERATIVE
a Computershare company

We believe that a central tenet of any GSE reform effort should be the creation of a level playing field that allows smaller lenders to compete with our larger counterparts. To achieve this objective, it will be necessary to both maintain the small lender protections currently in place and develop new protections that ensure fair access to the secondary market.

Fortunately, a plan put forth by the Mortgage Bankers Association (MBA) proposes actionable steps to bring about these small lender protections. I served on the MBA task force that was charged with developing this plan. The task force was comprised of members covering a broad cross-section of the real estate finance industry, including bank and nonbank lenders serving the single-family and multifamily markets and spanning a wide range of sizes and business models. The members of the task force spent more than a year considering potential approaches before issuing final recommendations for an improved secondary market.

The MBA plan, which features well-capitalized, privately-owned Guarantors performing many of the functions of the GSEs while subject to utility-style regulation, calls for a housing finance system that:

- ensures small lenders have equitable, transparent, and direct access to the secondary market;
- prohibits guarantee fee pricing or underwriting standards that are based on the loan volume of a given lender;
- preserves the ability of lenders to deliver small quantities of loans to the secondary market through mechanisms such as a cash window;
- maintains the "bright line" between the primary and secondary markets to keep Guarantors from competing with lenders;
- prevents larger lenders from gaining a competitive advantage by owning or controlling a Guarantor; and
- reduces the operational risks during a transition period by preserving certain elements of the current housing finance system.

While progress has been made towards some of these goals through administrative reforms put in place by the Federal Housing Finance Agency (FHFA), it is critical that we not take these reforms for granted. Comprehensive legislation is the final step that is needed to ensure these reforms are not weakened or reversed in future

814 A1A North, Suite 303
Ponte Vedra Beach, FL 32082
phone 904.543.0052
www.capmkts.org

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a Computershare company

U.S. Senate Committee on Banking, Housing, and Urban Affairs
July 18, 2017
Page Three

administrations. Until Congress acts, smaller lenders will continue to face uncertainty about the future and the prospect of a return to a highly concentrated mortgage market will remain.

To avoid this outcome, we encourage the Senate Banking Committee to continue its efforts towards legislative reform of the GSEs. By enacting comprehensive reforms, the Committee can ensure that the mortgage market remains competitive and that a diverse set of lending institutions are available to serve a wide range of creditworthy borrowers.

We thank you for your consideration of our views, and we look forward to working with you to achieve bipartisan, legislative GSE reform.

Sincerely,

Tom R.S. Millon, CFA, CMB
President and CEO
Capital Markets Cooperative, a Computershare Company
Ponte Vedra Beach, Florida

LETTER SUBMITTED BY THE MORTGAGE COLLABORATIVE

The Mortgage COLLABORATIVE

July 17, 2017

The Honorable Mike Crapo
Chairman
Senate Committee on Banking,
Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Senate Committee on Banking,
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534 Dirksen Senate Office Building
Washington, D.C. 20510

Chairman Crapo and Ranking Member Brown,

A discussion about the future of Fannie Mae and Freddie Mac (the Enterprises) must focus on the core principal of maintaining a vibrant and dynamic mortgage market which fosters and protects the critical role played by small and mid-sized lenders. As you are may be aware, small and mid-sized lenders operate in every region of the country, often providing access to mortgage credit for borrowers who would not otherwise be served by larger institutions. The presence of small and mid-sized lenders also spurs competition in the market and increases choices for borrowers.

The Mortgage Collaborative (TMC) is a lender cooperative that is singularly focused on needs of the small and mid-sized mortgage providers as well as community banks. TMC helps our members compete more effectively in the market by reducing the cost of running the business and by facilitating industry best practices. Currently our organization is made up of 113 independent mortgage originators and community banks originating more than $185 billion annually in all regions of our country.

The outcome of the housing finance reform debate will directly affect the ability of our member institutions to compete on a level playing field with their larger counterparts. Without clear and well-defined protections for small and mid-sized institutions, we risk reverting to the highly concentrated mortgage market that persisted in the lead-up to the financial crisis. In particular, reforms should ensure that small and mid-sized lenders have direct access to the secondary market without any forced dependence on a larger institution acting as an aggregator.

To its credit, the Federal Housing Finance Agency (FHFA), while acting as conservator of the Enterprises, has taken steps to level the playing field for lenders of all size. For example, FHFA has stopped the Enterprises from offering special deals, such as favorable guarantee fee pricing or underwriting variances, to lenders based on their loan volume. Such actions, among other market dynamics, have contributed to the reduced concentration in the mortgage market over the past several years.

While we are encouraged by the efforts of FHFA, there are limits to the progress that can be made administratively. FHFA cannot change the GSE charters—or its own regulatory mandate—to include protections for lenders of varying sizes and business models. Further, any reforms enacted by FHFA to date may be diluted or even reversed by future Administrations.

Because of these concerns, we remain steadfast in our belief that approaches based on recapitalizing the Enterprises and releasing them from conservatorship would not adequately protect small lenders. It is necessary for Congress to take actions to provide for the more comprehensive and long-lasting reforms that would ensure a more diverse, competitive mortgage market.

Among the various proposals for legislative reform of the Enterprises, we believe that the plan introduced by the Mortgage Bankers Association (MBA) would be most effective in creating a level playing field for all lenders. The MBA plan contains a number of specific steps to achieve this outcome, such as:

- ensuring fair and direct secondary market access for lenders of all sizes;
- prohibiting guarantee fee pricing that is influenced by the volume of loans delivered;
- maintaining cash window and small pool execution options;
- preserving the "bright line" separating primary and secondary markets;
- preventing vertical integration that could occur if larger lenders were allowed to own Guarantors; and
- minimizing the operational risks associated with the transition to a new system by leveraging the infrastructure of the current system wherever possible.

To be more certain that these protections will not be eroded over time, they should be codified through legislative reform and overseen by a regulator with utility-style authorities to ensure that Guarantors balance the interests of consumers, lenders, and investors. Such an approach is the best way to provide the legitimacy and certainty that small and mid-sized lenders require to effectively serve their communities.

On behalf of our 113 independent mortgage banks and community banks, we urge the Committee to work expeditiously towards a bipartisan proposal that would foster a strong, vibrant secondary mortgage market that is accessible to all lenders.

Sincerely,

Jim Park
CEO
The Mortgage Collaborative

STATEMENT SUBMITTED BY THE MORTGAGE BANKERS ASSOCIATION

ONE VOICE. ONE VISION. ONE RESOURCE.

Statement of the Mortgage Bankers Association
Submitted for the Record to the U.S. Senate Committee on
Banking, Housing, and Urban Affairs

Housing Finance Reform:
Maintaining Access for Small Lenders

July 19, 2017

MBA.ORG

MBa
MORTGAGE BANKERS ASSOCIATION

The Honorable Mike Crapo
Chairman
U.S. Senate Committee on
Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
U.S. Senate Committee on
Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Chairman Crapo and Ranking Member Brown,

The Mortgage Bankers Association (MBA) applauds the Committee's ongoing work towards reform of the nation's housing finance system and appreciates the attention given to the critical role of small and mid-sized lenders in this system. I write today to expand upon my written testimony and oral remarks at the Committee's hearing titled "Principles of Housing Finance Reform" held on June 29, 2017, as well as to highlight the emerging alignment among industry stakeholders on the measures necessary to protect small and mid-sized lenders.

The MBA's diverse membership of lenders, investors, brokers, vendors, and others in the real estate finance sector includes nearly 650 independent mortgage bankers, community banks, and credit unions, representing almost 80 percent of our single-family membership.

As you know, MBA recently put forth a detailed proposal for an improved secondary mortgage market that we believe will lead to a more stable system that protects taxpayers while also promoting broad credit availability in a primary market featuring lenders of all sizes and business models. To ensure that our proposal reflected the views of our diverse membership, we convened a task force that included a broad cross-section of the industry, including members—both bank and nonbank—representing small and mid-sized lenders.

Our plan features a number of provisions specifically designed to protect small and mid-sized lender access to the secondary market *(see Exhibit A – Small Lender Access: Why It Matters)*. These provisions include:

- Specifying equitable, transparent, and direct access to secondary market programs in both the mandate of the regulator and the charters of the Guarantors;
- Prohibiting special pricing or underwriting exceptions for certain lenders based upon loan volume or other elements of their business model;
- Requiring all Guarantors to offer cash window and small pool execution options;
- Preventing vertical integration by instituting strict statutory limits on lender ownership stakes in Guarantors;
- Maintaining the "bright line" separating the primary and secondary markets to ensure that Guarantors do not compete with lenders; and

- Minimizing operational risks associated with the transition to a new system by preserving the assets and infrastructure of the current system wherever possible.

Despite differing views on the ultimate end state of housing finance reform, recent publications and statements by a variety of groups representing segments of the real estate finance industry have largely converged on a set of protections that are needed for small and mid-sized lenders *(see Exhibit B – Alignment of Small and Mid-sized Lender Protections in GSE Reform)*.

For example, there appears to be widespread agreement that volume-based discounts or other preferential pricing and underwriting should be prohibited. Similarly, the availability of a cash window or other mechanisms by which lenders can deliver individual loans (or small pools of loans) to the secondary market—either servicing retained or released—is broadly accepted. These protections, as well as the others listed above, further the objective of fair and direct secondary market access for all lenders, which is critical for fostering competition that benefits consumers through greater choices and lower costs.

It cannot be stressed enough that the ongoing policy debate is not about *whether* small and mid-sized lender protections are needed; rather, the debate is about *how* to best provide these protections. Some organizations have argued that comprehensive reform is unnecessary, as small and mid-sized lenders have gained market share in recent years and the Federal Housing Finance Agency (FHFA) has put in place a number of administrative reforms that promote direct secondary market access.

Without legislation to enshrine these administrative reforms into law, however, any gains that have been made by small and mid-sized lenders remain subject to the discretion of future FHFA directors. Post-crisis actions undertaken by FHFA could be rolled back or even reversed in future administrations. And if Fannie Mae and Freddie Mac are released from conservatorship without further legislative reforms, FHFA cannot wield its authorities as conservator—which are considerably stronger than its authorities as regulator—to adequately protect small and mid-sized lenders.

While some stakeholders find the competitive balance in the current market to be acceptable, it is a mistake to simply assume that this environment will persist if no further action is taken. It is only through legislative reform that small and mid-sized lender protections can be "locked in" to truly ensure a level playing field in the future. Without such legislative reform, the possibility of returning to a market in which larger institutions are aided by special deals or lax regulation, and which therefore becomes more concentrated and less diverse, remains too great.

We fully acknowledge that the risks of any transition to a reformed housing finance system should not be underestimated; MBA has laid out a detailed transition road map to address these risks. What is underappreciated by far too many, however, are the risks associated with failure to institute structural reforms. If we want to develop and maintain a competitive primary market with equitable access to the secondary market, legislative reform offers the best path forward.

MBA again thanks the Committee for its consideration of these views, as well as its focus on issues specific to the small and mid-sized lenders that serve borrowers throughout the country.

Sincerely,

David H. Stevens, CMB
President and Chief Executive Officer
Mortgage Bankers Association

Exhibit A

Small Lender Access: Why It Matters

Small Lender Access: Why It Matters

It is important to recognize and address in reform legislation the role that limited access to the GSEs played in driving the sharp consolidation that began in the late-1990s. Between 1998 and 2010, the market share of the 10 largest single-family originators rose from less than 40% to almost 80%.

The GSEs played a significant role in driving this concentration. Beginning in the late 1990s, the GSEs competed for business by negotiating market share agreements with the largest volume lenders, providing lower guarantee fees and underwriting exceptions that drove even more business to these institutions. Unable to compete against lower guarantee fees and aggressive underwriting variances, smaller lenders were forced to deliver their loans to the largest lenders. This "aggregation" model played a contributing role in the GSEs' financial troubles by driving underpriced guarantee fees, spreading weak underwriting standards, and concentrating counterparty risk into a handful of aggregators.

In the wake of the crisis, the market share of home mortgage originations from the larger institutions declined sharply. By 2015, large depository institutions' market share had fallen to 21 percent for purchases, and 27 percent for refinances.[A] Several factors — legacy issues with pre-crisis mortgage and servicing portfolios, Basel III rules, regulatory burden and reputational risk in the mortgage business — all played a role in the decision of larger banks to shift their capital into more promising lines of business.

Fortunately for consumers, the gap in funding was filled by independent mortgage bankers (IMBs), whose market share in both purchases and refinances increased from the low-20s in 2008 to nearly 48 percent in 2015. Most of these institutions are smaller companies, but several IMBs grew to become top 20 originators. Community banks and credit unions also picked up market share, despite a decline of more than 1,100 reporting institutions.

Importantly, FHFA helped facilitate the transition through key policy changes intended to strengthen access to the GSEs for smaller lenders, including requiring guarantee fees to be based on the underlying loan risk (not loan volume), and eliminating preferential underwriting standards for selected institutions. Direct access to the GSEs' cash and MBS windows played a critical role in the recovery by ensuring these smaller lenders could provide the liquidity the market needed.

MBA believes that the mortgage market and consumers benefit from a large and diverse base of lenders. Smaller lenders, in particular, play a key role in strengthening the system for consumers by focusing on niche markets and leveraging unique knowledge of local consumer needs. Recent post-crisis research shows that highly concentrated mortgage markets through the 2000s reduced the sensitivity of mortgage rates to movements in the MBS market, and that more competitive local markets tended to narrow primary-secondary market rate spreads and deliver lower rates to consumers.[B]

- To that end, the Task Force's recommendations embody several key small-lender principles:
- Ensure equitable, transparent and direct access to secondary market programs;
- Prohibit G-fee pricing based on loan volume or asset size of single-family lenders;
- Preserve cash window and small pool execution options for smaller lenders;
- Maintain the "bright line" to ensure that Guarantors do not compete with lenders;
- Prevent vertical integration by prohibiting lenders from owning or controlling a Guarantor.

A. *MBA Executive DataBook, 2015 Origination Trends*, © 2016.

B. *Concentration in Mortgage Lending, Refinancing Activity and Mortgage Rates*, NBER Working Paper Series; David S. Scharfstein, Adi Sunderam, Working Paper 19156; http://www.nber.org/papers/w19156.

Exhibit B

Alignment of Small and Mid-sized Lender Protections in GSE Reform

ONE VOICE. ONE VISION. ONE RESOURCE.

Alignment of Small and Mid-sized Lender Protections in GSE Reform

	MBA	ABA	ICBA	CMLA	CHLA	NAFCU
Requires equitable access to the secondary market as part of the regulatory mandate and/ or GSE/Guarantor charters	Yes	Yes	Yes	Yes	Yes	Yes
Maintains the "bright line" between primary and secondary markets to ensure GSEs/Guarantors do not compete with lenders	Yes	Yes	Yes	Not explicitly discussed	Not explicitly discussed	Not explicitly discussed
Prohibits preferential pricing or disparate underwriting standards for lenders based on loan volume	Yes	Not explicitly discussed	Yes	Yes	Yes	Yes
Mandates that credit risk transfers be designed to avoid market concentration	Not explicitly discussed	Not explicitly discussed	Yes	Yes	Yes	Yes
Requires GSEs/Guarantors to maintain cash window and small pool execution options	Yes	Yes	Yes	Yes	Yes	Yes
Provides statutory limits on lender ownership of GSEs/Guarantors	Yes	No	No	Yes	Yes	No

MBA.ORG/GSEREFORM

MBA. MORTGAGE BANKERS ASSOCIATION

JOINT LETTER SUBMITTED BY CONSUMER AND HOUSING INDUSTRY GROUPS

July 19, 2017

The Honorable Tim Scott
United States Senate
717 Hart Senate Office Building
Washington, DC 20510

The Honorable Mark Warner
United States Senate
703 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Scott and Senator Warner:

The undersigned organizations that represent a broad array of consumer and housing industry groups commend you for your continued focus on expanding access to credit for creditworthy homebuyers and, in particular, for what we understand to be your willingness to introduce bi-partisan legislation entitled the "Credit Score Competition Act." Your bill, if enacted into law, will responsibly expand mortgage credit for millions of hardworking potential homebuyers without sacrificing credit standards by introducing innovation and market competition into the credit scoring system utilized by Fannie Mae and Freddie Mac (Enterprises).

The "Credit Score Competition Act" would allow many households, especially the growing minority communities and other potential first-time homebuyers, to achieve homeownership by instructing the Enterprises to update their underwriting requirements so that lenders could choose to utilize newer, more predictive and inclusive credit scoring models than is currently the case. Given the expanded data available using newer credit scoring models that are empirically derived, statistically sound and demonstrably valid would provide for greater predictability and create needed competition in the market while simultaneously reducing credit risk for the Enterprises.

It is well-established that consumers benefit from competitive markets -- and that is certainly true when it comes to credit scores. We understand there are alternative scoring models that can score up to 35 million more consumers than the legacy FICO model long-required by the Enterprises. The FICO models that the Enterprises require lenders to use today desperately need updating since they were developed on pre-recession data from more than 20 years ago. According to several studies the previously un-scoreable consumers capable of being scored by more recently introduced models tend to be immigrants and minorities, infrequent credit users and new entrants into the credit market. These groups represent the major growth segment in terms of new business opportunity and would increase housing demand as well as stimulate job growth in the housing industry throughout the country.

As organizations focused on expanding sustainable access to mortgage credit, we urge your Senate colleagues to join with you in supporting this important bi-partisan effort to provide access to mortgage credit by qualified borrowers currently locked-out of the market by allowing competition regarding the credit scoring requirements of the Enterprises. Many consumers face challenges in accessing mortgage credit, but denying creditworthy borrowers access to credit merely because the Enterprises insist on using standards that are woefully out-of-date should not be one of them. We thank you for authoring legislation to eliminate the Enterprises' reliance on a single legacy credit scoring model, and urge your Senate colleagues to join you in supporting the "Credit Score Competition Act."

Thank you for your leadership on this critically important matter.

Sincerely,

America's Homeowners Alliance
Asian Real Estate Association of America
Consumer Federation of America
Community Associations Institute
Community Home Lenders Association
Community Mortgage Lenders of America
Leading Builders of America
National Association of Home Builders
National Association of REALTORS®
National Association of Hispanic Real Estate Professionals
National Community Reinvestment Coalition
National Fair Housing Alliance
RESPRO
The Realty Alliance

cc: U.S. Senate Committee on Banking, Housing, and Urban Affairs

LETTER SUBMITTED BY THE MORTGAGE BANKERS ASSOCIATION

MBa®

MORTGAGE BANKERS ASSOCIATION

July 21, 2017

The Honorable Tim Scott
United States Senate
717 Hart Senate Office Building
Washington, DC 20510

The Honorable Mark Warner
United States Senate
703 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Scott and Senator Warner:

MBA commends your bipartisan efforts and your willingness to introduce the Credit Score Competition Act that will help expand access to credit for creditworthy American homebuyers. Your bill would responsibly expand mortgage credit for millions of hardworking Americans without compromising credit quality. Additionally, it would introduce more innovation and market competition into the credit scoring system utilized by Fannie Mae and Freddie Mac (the GSEs).

Last year, MBA requested the Federal Housing Finance Agency (FHFA) to publish a Request for Input (RFI) to solicit comments on its current proposals to update the GSEs' credit scoring criteria. MBA also urged FHFA to work with Fannie Mae and Freddie Mac to study the benefits of updating their credit scoring criteria to reflect:

- the latest generation of validated credit score models currently in use by the GSEs, and
- the benefits of requiring the GSEs to validate and provide lenders an option to use new or alternative scoring models in underwriting, product eligibility, and pricing grids.

MBA believes that the GSEs' timely review and incorporation of newer and alternative credit models is important to industry efforts to expand credit options for today's borrowers.

The Credit Score Competition Act would support these objectives by requiring the GSEs to establish a transparent and open process for the validation and approval of credit scoring models, and providing lenders the choice of selecting any approved model in originating and selling loans to the GSEs. This approach would allow for the public presentation of all proposed options, and would help facilitate a thoughtful industry discussion on the most suitable options to expand credit while promoting sustainable homeownership.

MBA supports the introduction of the Credit Score Competition Act to provide expanded credit scoring options for lenders and their customers, while preserving prudent oversight and risk management for the GSEs, and we appreciate your careful consideration of this important set of issues. Should you have questions or wish to discuss any aspect of these comments further, please contact Meghan Sullivan, Associate Vice President, Legislative and Political Affairs, at MSullivan@mba.org or (202) 557- 2866 or Brad Cheney, Associate Vice President, Legislative and Political Affairs, at BCheney@mba.org or (202) 557-2913.

Thank you in advance for your consideration of the views expressed within this letter.

Sincerely,

Bill Killmer
Senior Vice President
Legislative and Political Affairs

cc: The Honorable Ed Royce
The Honorable Kyrsten Sinema
The Honorable Terri Sewell

JOINT LETTER SUBMITTED BY SENATOR SCOTT

July 25, 2017

The Honorable Tim Scott
The Honorable Mark Warner
United States Senate
Washington, DC 20510

Dear Senator Scott and Senator Warner:

Thank you for your work on the Credit Score Competition Act, which will help consumers by increasing competition among credit score providers in the mortgage market. This legislation will especially help unbanked or under-banked consumers.

The Credit Score Competition Act would end a government-sanctioned quasi-monopoly that chokes off real innovation and hurts consumers who otherwise would receive more favorable mortgage terms. Fannie Mae and Freddie Mac today require the use of credit score models that were developed using data from 1995 to 2000. This serves to disqualify, or "price out" many would-be borrowers whose credit reports cannot generate a credit score or who end up paying significant penalties based on their credit scores.

This credit scoring requirement remains even though there are other validated scoring models that are more predictive, more inclusive and more consumer-friendly. These other models are readily available and have been widely-adopted by lenders in the credit card, auto and personal lending industries.

The Credit Score Competition Act would grant authority to the Federal Housing Finance Agency, the GSEs' conservator, to establish standards and criteria for any process used by either enterprise to validate and approve credit scoring models. This proposal would not mandate that the GSEs adopt other scoring models, but simply put in place a mechanism for consideration and review of other scoring models. Likewise, this proposal would not in any way undermine the rigorous underwriting standards in place today.

The Credit Score Competition Act will help consumers and communities across the United States. Thank you again for introducing this legislation and we look forward to working with you and your colleagues to secure its passage.

Sincerely,

Center for Financial Services Innovation
Consumer Data Industry Association
Consumer Mortgage Coalition
Housing Policy Council of the Financial Services Roundtable
National Association of Federally-Insured Credit Unions

JOINT LETTER SUBMITTED BY SMALL AND MID-SIZED TRADE ASSOCIATIONS

July 19, 2017

The Honorable Mike Crapo
Chairman
Senate Committee on Banking,
Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Senate Committee on Banking,
Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Chairman Crapo and Ranking Member Brown,

The undersigned trade associations represent predominantly small and mid-sized lenders involved in financing housing for low- and moderate-income families and first-time homebuyers. Our members serve consumers across the country, often providing access to mortgage credit for borrowers who would not otherwise be served by larger institutions. The presence of small lenders also spurs competition in the market and increases choices for borrowers.

As the Committee embarks on the task of reforming Fannie Mae and Freddie Mac (the Enterprises), it is critical to address how those reforms will impact the ability of small lenders to compete fairly and serve local housing markets effectively. Without clear and well-defined protections for small lenders, housing finance reform—or the failure to act on sensible reforms—risks returning us to the highly-concentrated mortgage market that persisted in the lead-up to the financial crisis. Most importantly, housing finance reform must ensure that small lenders have direct access to the secondary market and options to sell loans servicing retained or released without any forced dependence on a larger institution acting as an aggregator.

There have been many proposals released recently to address housing finance reform. Many support the principle of protecting small lender access. However, the plan developed by the Mortgage Bankers Association (MBA) backs that principle with detailed, specific proposals—in statute—to create a level playing field for small and mid-sized lenders, including:

- requiring the regulator to ensure fair and direct secondary market access for small lenders;
- prohibiting guarantors from charging lower guarantee fees or offering special underwriting concessions based on the volume of loans delivered, or other opaque criteria not open to all lenders;
- maintaining cash window and small pool execution options, including the option for lenders to sell loans servicing retained or released;
- preserving the "bright line" separating primary and secondary markets so that the guarantors cannot compete with lenders or pick winners and losers;
- enforcing strict limits on the ability of a large bank or lending institution to acquire a controlling interest in a guarantor in order to prevent vertical integration; and

- minimizing "switching costs" to the new system and ensuring a smooth transition by leveraging the infrastructure of the current Enterprises wherever possible.

To its credit, the Federal Housing Finance Agency (FHFA), while acting as conservator of the Enterprises, has taken some steps to level the playing field for small lenders. For example, FHFA has stopped the Enterprises from offering special deals, such as favorable guarantee fee pricing or underwriting variances, to lenders based on their loan volume. The MBA and undersigned state associations have supported those actions, and they have effectively contributed to the reduced concentration in the mortgage market over the past several years.

However, there are limits to the progress that can be made administratively, and there are no guarantees that a future FHFA director would continue or maintain these initiatives. Only through legislation can we lock in these important gains. True reform of the Enterprises must also include legislative reforms of the regulator that would impose a utility-style regulatory framework that balances the interests of guarantors (and their investors), their customers (e.g., lenders and servicers), and the consumers they both serve. This "regulatory compact" is necessary to ensure no undue exercise of market power by a handful of market participants given their unique power to place a full faith and credit federal guarantee on mortgage securities.

Such an approach is the best way to provide the legitimacy and certainty that small lenders require to effectively serve their communities. On behalf of our associations and the small and mid-sized lenders we represent, we urge the Committee to work expeditiously towards a bipartisan proposal that would foster a strong, vibrant secondary mortgage market that is accessible to all lenders.

Sincerely,

Mortgage Bankers Association of Alabama
Arizona Mortgage Lenders Association
Mortgage Bankers Association of Arkansas
California Mortgage Bankers Association
Colorado Mortgage Lenders Association
Connecticut Mortgage Bankers Association
Delaware Mortgage Bankers Association
Mortgage Bankers Association of Metropolitan Washington
Mortgage Bankers Association of Florida
Mortgage Bankers Association of Georgia
Mortgage Bankers Association of Hawaii
Idaho Mortgage Lenders Association
Illinois Mortgage Bankers Association
Indiana Mortgage Bankers Association
Mortgage Bankers Association of Kentucky
Maine Association of Mortgage Professionals
Maryland Mortgage Bankers and Brokers Association

Massachusetts Mortgage Bankers Association
Michigan Mortgage Lenders Association
Mortgage Bankers Association of Greater Kansas City
Nebraska Mortgage Association
Nevada Mortgage Lenders Association
Mortgage Bankers and Brokers Association of New Hampshire
Mortgage Bankers Association of New Jersey
New Mexico Mortgage Lenders Association
New York Mortgage Bankers Association
Mortgage Bankers Association of the Carolinas
Ohio Mortgage Bankers Association
Oklahoma Mortgage Bankers Association
Oregon Mortgage Bankers Association
Rhode Island Mortgage Bankers Association
Tennessee Mortgage Bankers Association
Vermont Mortgage Bankers Association
Virginia Mortgage Lenders Association
Washington Mortgage Bankers Association
Wisconsin Mortgage Bankers Association